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RE: EBR Registry Number 012-6837, Cap and Trade Regulatory Proposal and Revised Guideline for Greenhouse Gas Emissions Reporting

Dear Ms. Ollevier,

The Clean Economy Alliance (CEA, or the Alliance) is pleased to make the following submission concerning the proposed Cap-and-trade Regulatory Proposal and Revised Guideline for Greenhouse Gas Emissions Reporting, published February 25, 2016.

The CEA is a group of over 90 organizations representing a broad cross-section of Ontarians that united last year to urge Ontario (or the province) to show leadership in addressing the crucial issue of climate change. (See Appendix 1 for full membership list). The CEA includes prominent Ontario businesses, industry associations, labour unions, farmers' groups, health advocates, and environmental organizations. The Alliance supports the Ontario government's commitments to develop and implement a climate change strategy and cap-and-trade program. We recognize that reducing greenhouse gas (GHG) emissions will bring many benefits, including cleaner air, improved public health, and more jobs and business opportunities in the clean economy.

In April 2015, the Alliance established six principles of carbon pricing (see Appendix 2), followed in September 2015 by a more detailed set of recommendations (see Appendix 3) for the design of Ontario's cap-and-trade program. These principles continue to guide the CEA's recommended approach to cap-and-trade design and are reflected throughout this submission.

The CEA welcomes Ontario's plan to put a price on carbon pollution with a cap-and-trade program. The Alliance believes that carbon pricing is a significant policy instrument that can help to ensure the province reaches its targets of reducing GHG emissions—so long as the cap-and-trade system is designed to be effective, predictable, stringent, fair, transparent and durable.

Specifically, the CEA recommends that the regulations be improved to:

- require a compliance obligation for new facilities as soon as they begin operating
- prohibit the allocation of free allowances to new facilities and voluntary participants
- provide increased clarity and transparency in the application of allocation methods for free allowances

- adopt a transparent, data-driven approach to determining which industries are energy-intensive and trade-exposed
- establish a detailed timeline for the phase-out of free allowance allocation
- provide more information to the public about the distribution, auctioning, and sale of emissions allowances
- reduce the discretionary powers allotted to the Minister of the Environment and Climate Change regarding the removal of emissions allowances and credits from an entity's holding accounts

1. Coverage

i. Mandatory Participation

The cap-and-trade regulation requires certain emitters to register as mandatory participants under the *Climate Change Mitigation and Low-Carbon Economy Act* (Bill 172, or the Act) and surrender compliance units for emissions above their limit. The system also allows certain emitters to "opt-in" as voluntary participants under the Act. Together, mandatory and voluntary participants are referred to as "capped participants", which include:

- Industrial and large commercial operators
- Institutions
- Petroleum product suppliers
- Natural gas distributors
- Electricity, including imported electricity for consumption in Ontario

Ontario's draft cap-and-trade regulation appears to exempt electricity generators from mandatory participation. However, in fact what the system does is shift the point of regulation such that the natural gas fuel distributors to the electricity sector become responsible for the emissions associated with electricity generators.

For domestic electricity generation, the point of regulation will be the fuel distributors providing fossil fuel to such electricity generation facilities. In other words, the electricity generation emissions would be "attributed" to the natural gas distributors providing those generators with the fuel. The exception to this general rule is where generation facilities receive fuel directly from inter-provincial or international natural gas pipelines, i.e. not via a gas distribution utility. In this case, the generation facilities themselves will be required to register as mandatory participants. For electricity imports, the mandatory participant will be the "first jurisdictional deliverer" (i.e. the entity who first imports the electricity into the province). As noted below, the cap-and-trade regulation also does not permit electricity generators to opt into the cap-and-trade program.

Moving the point of regulation from electricity generators to their fuel providers is divergent from the approach taken by California and Quebec and it does make it more difficult for electricity generators to manage their carbon costs. That said, given Ontario's unique situation and complicated regulatory environment, this approach provides an elegant and administratively workable system that recognizes Ontario's role in reducing GHGs through the phase out of coal-fired electricity generation and avoids the need to reopen power purchase agreements to account for new carbon costs.

The CEA supports this design element, as it will likely lower administrative costs and should not result in significant environmental effects.

ii. Voluntary Participation

In addition to the mandatory participants identified above, the Regulation allows certain entities to opt into the cap-and-trade program as "voluntary participants." Specifically, entities with annual GHG emissions of 10,000-25,000 tonnes who are required to submit emissions reports but are not required to have them verified can choose to opt-in as voluntary participants.

The CEA commends the Ministry of Environment and Climate Change's (MOECC, or the Ministry) inclusion of voluntary participants within the cap-and-trade program. This inclusion provides entities flexibility and greater ability to manage their compliance obligations as well as their carbon costs.

iii. New Facilities

Section A.1 of the cap-and-trade regulation (concerning free allowances) provides that "[n]ew facilities…do not have a compliance obligation in the first two years of operation". New facilities are defined as "any existing facility that has to be verified and is 25,000 tonnes of CO_2e or more for the first time in or after 2017" and "any facility that begins operations in January 1, 2016 or later that has annual emissions that have to be verified and is 25,000 of CO_2e or more per year".

This exemption of new facilities should be addressed earlier in the cap-and-trade regulation, as it relates to coverage and not just the allocation of free allowances. The definition of "new facility" should also be included in the definitions section and not embedded in the Appendix.

MOECC should not exempt new facilities for the first two years of operation (and then allow them to apply for free allowances for an undefined period of time, as discussed below). This disincentivizes companies from transitioning to low-carbon business models and operations. At the very least, this two-year grace period should be phased out after the first compliance period or earlier to ensure that new facilities are managing their carbon costs from the start.

2. Compliance Periods

The first compliance period for covered emitters would run from January 1, 2017 until December 31, 2020, with successive three-year compliance periods after that date. The first true-up wouldn't be until November 1, 2021.

The cap-and-trade program should have an annual compliance requirement of 70 to 80 per cent and a 100 per cent true-up at the end of the first compliance period. Having regular annual true-ups will help entities familiarize themselves with the program, demonstrate progress (or lack thereof) toward 2020 climate targets, and reduce the risk of an entity going out of business before 2021 without trueing-up.

3. Market Participants

Section 16 of the cap-and-trade regulation states that "[a] person who is not an employee of a mandatory or voluntary participant may apply to the Director for registration as a market participant in the cap-and-trade program…" It is unclear why the cap-and-trade regulation specifies only that an employee of a mandatory or voluntary participant may not apply to be a market participant – would an officer, director or other person be eligible to apply?

Moreover, neither the Cap-and-trade regulation nor the Act provide further detail regarding the definition of a "market participant" or what would disqualify a person or entity from becoming a market participant under the cap-and-trade program.[1]

MOECC should clarify who may apply as a market participant or include further parameters. The concern that hedge funds or similar entities might enter the market and buy up large volumes of allowances should be addressed through the four per cent purchase limit for market participants described below. However, more clarity is warranted around who these market participants are and what their role is envisioned to be.

4. Free Allowances

The Appendix to the regulation addresses a capped participant's eligibility for free allowances and how free allowances will be allocated.

i. Eligibility

Certain large industrial emitters who are required to report and verify their emissions from activities listed in Table 2 of the Reporting Regulation are eligible to apply to receive free allowances during the first compliance period (and potentially beyond). These would include: cement, iron and steel, mining, petroleum refining and hydrogen, among others. Emissions from the following types of operations, among others, are not eligible to receive free allowances:

- Electricity generators or importers
- Petroleum product suppliers
- Natural gas distributors

Sections A.2.7 and A.2.8 provide that voluntary participants and new facilities are also eligible to apply for free allowances (though new facilities must wait until their third year of operations when their compliance obligations kick in).

Appendix section A.1 states that new facilities do not have a compliance obligation in the first two years and thus will not be eligible to apply for allowances. The current language of the provision suggests that

[1] The definition of "market participant" in the Act is "a person who is registered as a market participant under section 17". Section 17 of the Act states that "[a] person who satisfies such eligibility criteria as may be prescribed may apply to the Director in accordance with the regulations for registration as a market participant in the cap-and-trade program under this Act". The Cap-and-trade Regulation does not include a definition of "market participant".

new facilities will, however, be eligible to apply for free allowances starting in their third year of operations once their compliance obligation kicks in.

Voluntary participants and new facilities should be excluded from this transitional measure. Voluntary participants should decide to opt-in for the purposes of better managing their carbon costs, not to avoid carbon costs altogether via free allowances. New facilities already enjoy a two-year grace period before compliance obligations kick in and companies would factor in the price of carbon as part of their decision to locate new facilities in Ontario. Overall, making free allowances widely available goes beyond the rationale of addressing competitiveness and leakage risks, could disincentivize companies from taking early action and will prolong the very transition these measures seek to accommodate.

ii. Allocation Methods

Section A.2 indicates that the "Director *may* consider four types of allocation methods for facilities eligible for free emission allowance allocation" (emphasis added). The applicant must provide all information necessary for the Director to determine which allocation method – or *methods* – will apply.

The following four allocation methods are available for consideration.

- Product-output benchmark allocation
- Energy use-based allocation
- History-based allocation
- Direct allocation

For both voluntary participants and new facilities, free allowances will be allocated based on a hierarchy of allocation methods. That is, where product benchmarks are available in Table 1 of the cap-and-trade regulation, the product-output benchmark approach will be applied. Where no such benchmark is available, the energy-use based allocation method will apply.

For comparison, California's distribution of industrial assistance allocations is determined using a combination of product-based and energy-based methodologies.[2] In Quebec, between 2013 and 2014, allowances were freely allocated based on an entity's average historic emissions intensity between 2007 and 2010 and adjusted for production output. From 2015 to 2020, the number of free allowances per unit of production generally decreases by 1% to 2% per year to provide emitters with an additional incentive to reduce their GHG emissions.[3]

Ontario has decided on a hybrid of California and Quebec's approaches. It appears that in certain cases more than one of Ontario's allocation methods could apply. In cases where more than one method could apply, it does not appear that a hierarchy of methods has been proposed, nor are there details regarding how the Director will decide among the various methods.

MOECC should provide more detail regarding which allocation method will apply to each sector or group of mandatory participants. The hierarchy of allocation methods for existing facilities should be

[2] Sections 95852.2(e), 95870(e), 95890, 95891, and 95894 of California's Cap-and-Trade Regulation.
[3] Québec Cap-and-trade, 2011. Title III, Chapter II, Division II, Section 40.

similar to the one proposed for voluntary participants and new facilities. Overall, the Alliance recommends:

- ***Clarity on allocation methods and when they will apply***
- ***Transparency in the process of determining which method applies***
- ***Transparency in the process of applying the method to each facility***
- ***The ability to correct the Ministry's approach in the event that too many free allowances are being distributed***
- ***Measures to avoid gaming and manipulation***

iii. Free Allowances as a Targeted, Transitional Measure

Under the cap-and-trade regulation as proposed, large industrial emitters would receive a free allocation of emissions credits during the first compliance period. The introductory paragraphs of the Appendix state that the distribution of free allowances is "a temporary measure, meant to reflect both the need for Ontario facilities to transition to an environment where emitting GHGs carries a cost they must bear, and also to protect against carbon leakage".

The cap-and-trade regulation does not include an explanation of how competitiveness and leakage risks were identified for the purposes of this draft regulation or will be identified for the purposes of future decisions concerning free allowance allocation (which, we would expect, would become more targeted over the years). Unlike California, Ontario does not provide any formulas setting out how emissions-intensive, trade-exposed sectors will be determined. Others have noted that this type of broad, indiscriminate support is not environmentally or economically effective.[4] It could dampen the price signal the system intends to set and undermine the policy's effectiveness at reducing GHGs.[5] It could compromise political acceptance by treating firms or sectors differently. It could impose a greater burden on other sectors, including individuals and small businesses, raising serious questions of fairness.[6] And it could generate less revenue for investment in much-needed complementary measures.[7]

The CEA reiterates the point that it previously communicated in its December 2015 submission on the Proposed Design Elements that:

> ***"...any process for assessing and addressing competitiveness impacts must be rigorous, transparent and based on sound economic analysis. If any permits should be allocated without cost, they should only be granted to a very small set of industries where there is compelling evidence that there will be competitiveness challenges and leakage."***

The CEA recommends the adoption of clear criteria to determine leakage risk and identify those sectors that are truly vulnerable to competitiveness threats. In particular, the CEA recommends that:

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[4] Beugin, D, "How does Ontario's Cap-and-trade Program Design Options consider competitiveness pressures?" (25 November 2015), Canada's Ecofiscal Commission Blog, online: < http://ecofiscal.ca/2015/11/25/ontario-cap-and-trade-competitiveness/> [*Ecofiscal Commission Ontario Cap-and-trade*].
[5] Canada's Ecofiscal Commission, *Provincial Carbon Pricing and Competitiveness Pressures* (November 2015), online: < http://ecofiscal.ca/wp-content/uploads/2015/11/Ecofiscal-Commission-Carbon-Pricing-Competitiveness-Report-November-2015.pdf> at 14 [*Ecofiscal Commission Competitiveness Pressures*].
[6] *Ibid.*
[7] *Ibid*, at 17.

- ***Ontario should adopt a transparent, data-driven approach to determining which industries face competitiveness pressures.***
- ***Ontario should establish a clear test to determine which sectors are truly both emissions-intensive and trade-exposed, which should be made public and justified by compelling evidence and sound economic analysis. Such an approach will preserve the credibility and effectiveness of the system and protect against any actions based on politics.***

Ontario's cap-and-trade regulation does not indicate that it will publish which entities receive free allowances or how many free allowances each entity receives.

Quebec publishes the total number of allowances and the list of entities that receive them, but the exact number of allowances received by each entity is unreported and unclear.[8] Quebec's approach to the allocation of free allowances has been criticized for lack of transparency and political discrimination between sectors.[9] California follows a similar approach whereby the Air Resources Board publishes annual reports on free allowance allocation to industry but aggregates entities both by allocation methodology and, within the industrial allocation category, by North American Industry Classification System sector. To protect confidential business information for individual facilities, no industrial sector contains less than five companies.[10]

Ontario should publish at least as much information as its partner jurisdictions and, where possible, strive for even greater transparency.

Finally, the introductory paragraphs of the Appendix state that "[i]n future compliance periods, it is envisioned that fewer allowances would be distributed free of charge as Ontario facilities make the adjustment to carbon pricing". Despite noting that this is a temporary measure, the cap-and-trade regulation does not indicate whether or how free allowances will be distributed following the first compliance period. It is therefore unclear which sectors will continue to receive free permits and for how long.

Ontario should set out a detailed timeline for phasing out supportive measures, echoing the argument set out in the CEA's submission on the Proposed Design Elements: that the free allocation of allowances be transitional, decreasing consistently over time and in keeping with emissions intensity targets that also decrease consistently over time.

A detailed timeline will not only preserve the integrity of the system, it will also provide predictability to companies, allowing them to plan for the future and more effectively compete. They key is that industry does not plan on free allowances always being available but instead has a clear and predictable policy to help them with future planning.

5. <u>Related Persons with respect to Purchase Limits and Holding Limits</u>

[8] Clean Energy Canada, *Inside the World's Largest Carbon Market* (April 2015), online: <http://cleanenergycanada.org/wp-content/uploads/2015/04/InsideNorthAmericaLargestCarbonMarket_ENGL_Spreads2.pdf> at 16 [*CEC World's Largest Carbon Market*].
[9] *CEC World's Largest Carbon Market* at 16.
[10] http://www.arb.ca.gov/cc/capandtrade/allowanceallocation/v2015allocation.pdf

The term "related" or "related persons" is referenced numerous times throughout the cap-and-trade regulation with respect to purchase limits, holding limits and emissions trading, among other sections. What constitutes "related persons" is defined in section 21 regarding holding limits; however, it is unclear whether this definition applies beyond that section. For instance, section 21 states that:

> (6) *For the purposes of this section*, two persons are related persons,
>
> (a) if there is a direct or indirect relationship between them in which the first person,
> (i) owns more than 50 per cent of the securities of the second person or holds a call, option or other right or obligation to acquire such securities,
> (ii) shares more than 50 per cent of its officers or directors with the second person or may appoint up to 50 per cent of the officers or directors of the second person, or
> (iii) owns voting securities carrying more than 50 per cent of the voting rights attached to all voting securities in the second person;
>
> (b) if they each have the same designated account representative, and that same individual also performs other duties for one of the persons;
>
> (c) if the second person is a partnership other than a limited partnership and the first person holds more than 50 per cent of the interests in the partnership; or
>
> (d) if the second person is a limited partnership, the first person is the general partner of the partnership.
>
> (7) *For the purposes of this section*, a group of persons are related persons if two or more persons in the group are controlled by one of the persons in the group. (emphasis added)

The Ministry should clarify whether that definition of "related persons" applies throughout the cap-and-trade regulation and, if so, add it to the list of general definitions as opposed to embedding it in one specific section to avoid confusion.

6. Purchase and Sale of Emissions Allowances

The cap-and-trade regulation indicates that emissions allowances may be bought and sold in one of three ways:

(i) Auctions (s. 36)
(ii) Sales (s. 37)
(iii) Transfers between registered participants (i.e. trading) (s. 31)

i. Auctions (s. 36)

Section 36 provides that each year, the Minister shall auction Ontario emissions allowances on four separate occasions. Any allowances that were auctioned but not sold will be reserved for subsequent auctions, subject to certain conditions (see subsection 36(3)).

Subsection 35(4) provides that "[a]fter an order issued under paragraph 1 of subsection 14(8) of the Act[11], the Minister shall deduct from the Ontario emission allowances reserved by the Minister for the next auction a number of Ontario emission allowances equal to 25 per cent of the amount of the outstanding obligations at the time of the determination under section 13 of this Regulation[12]".

A separate note under this section states that the emission allowances remaining following the determination of the total amount to be distributed free of charge will be reserved for quarterly auctions for that year. In addition, ten per cent of Ontario emission allowances created with a vintage three years later than the current auction year would also be reserved for annual quarterly auctions. This breakdown appears to be inconsistent with what section 35 states regarding allowances to be reserved for sale under section 37 (see below).

MOECC should provide clarity regarding the total pool of allowances to be created each year and the percentage of that pool that would be (i) distributed free of charge; (ii) auctioned off in the current year; (iii) auctioned off in future years (if this is decided in advance as opposed to based on unsold allowances in past auctions); (iv) and sold by the Minister under section 37.

i. Sales (s. 37)

Section 35 provides that, each time the Minister creates Ontario emission allowances, five per cent of those allowances will be reserved for the purposes of sales under section 37. These will be classified as Category A, B and C, each class consisting of an equal number of emission allowances. Section 37 provides that the Minister will offer these allowances for sale to capped participants (not market participants) on four separate occasions each year. Any allowances that are not sold in that year will be reserved for subsequent sales.

Quebec's cap-and-trade program offers "sales by mutual agreement by the Minister" where the Minister of Sustainable Development, Environment, and the Fight Against Climate Change may hold a sale up to four times per year. There is no pre-set date for these sales and it is up to the Minister whether or not to hold them. Allowances are offered at a set price and come from the Minister's reserve. Sales by mutual agreement by the Minister are not joint sales and the units put up for sale come from Quebec's reserve accounts. Only those emitters whose accounts do not have enough allowances to cover their compliance

[11] **Continuing shortfall, consequences**
14 (8) If the Director gives the participant notice, in accordance with the regulations, of the participant's outstanding obligations under subsections (1) and (7), and if the participant does not satisfy the obligations in full by the deadline specified in the notice, the following consequences arise:
1. The Director may, by order, require the participant to pay to the Minister of Finance an amount determined in accordance with the regulations in satisfaction of the participant's outstanding obligations.
2. Until the participant's outstanding obligations are satisfied in full, the Minister may decline to distribute emission allowances free of charge to the participant.
3. The Director may, by order, impose such other consequences as may be authorized by regulation.

[12] Failure to remedy continuing shortfall 13. The amount required to be paid by an order under paragraph 1 of subsection 14 (8) of the Act shall be determined by applying the following formula: A = B × C Where, A = the amount required to be paid, B = the lowest bid price accepted for Auction Class 1 emission allowances at the most recent auction, C = the amount of outstanding obligations at the time of the determination.

obligations may participate in this type of sale.[13] California similarly holds quarterly sales of allowances from its Price Containment Reserve.[14]

The Ontario cap-and-trade regulation does not specify what the purpose of section 37 sales is, and whether such sales are "reserve sales" for the purpose of price containment. It is possible that section 37 sales could serve a broader purpose.

Section 59 sets out the formulas to be used in determining the price of Ontario emission allowances classified as Categories A, B and C. Each of these formulas is based, in part, on sales prices posted by Quebec for a reserve emissions unit in 2016. It is unclear why these sales prices are being used and whether Ontario emission allowance sales will be linked with Quebec's reserve sales. Moreover, it is unclear why 2016 sales prices will be used as opposed to 2017 prices.

MOECC should provide details regarding the purpose of section 37 sales, how the Minister will decide when or why such sales will be held, and whether any eligibility criteria apply. The Ministry should also provide clarification regarding whether such sales will be held jointly with Quebec or any other jurisdiction.

i. Transfers between registered participants (i.e. trading) (s. 31)

Section 31 of the Cap-and-trade regulation provides that "[a] registered participant may submit a request to the Minster to transfer emission allowances or credits from the participant's holding account to another registered participant's holding account…" Registered participants must provide information concerning (i) the number of emission allowances and credits to be transferred; (ii) a description of the emission allowances and credits; and (iii) except if the proposed transfer is between related persons, details with respect to the price to be paid for each emission allowance and credit. Registered participants will likely also be required to include details concerning the transaction agreement.

The MOECC notes that "Ontario is considering facilitating the participation of clearinghouses in the program to provide clearing services for transactions between registered participants". It is unclear whether all participant-to-participant transactions would be required to go through a clearinghouse and, if not, when a clearinghouse would be required and/or available.

MOECC should provide clarification regarding whether and when clearinghouses will be required for participant-to-participant transactions. MOECC should also ensure greater transparency requirements for transfers between related parties and any other element of the trading process to ensure a rigorous trading system is established.

[13] Quebec Ministry of Sustainable Development, Environment and the Fight Against Climate Change. (updated 2015) "The Carbon Market: Sales by mutual agreement by the Minister." Retrieved from http://www.mddelcc.gouv.qc.ca/changements/carbone/Ventes-gre-ministre-en.htm

[14] For more detail, see California Air Resources Board. (updated 2016). "Auction and Reserve Sale Information." Retrieved from http://www.arb.ca.gov/cc/capandtrade/auction/auction.htm#reservesale.

7. Penalties

Under section 14(7) of Bill 172, where a capped participant fails to surrender the number of compliance units (emissions or credits) required to account for its compliance obligations in a given compliance period, the Minister may remove allowances or credits from the participant's compliance or holding account. Participants will also be required to submit additional allowances in an amount equal to three times the shortfall, which the Minister may remove from the participant's cap-and-trade accounts as well. Under section 14(8) of the Act, where a participant continues to fail to remedy its shortfall, the Director may order the participant to pay the Minister of Finance an amount equal to the amount of outstanding obligations multiplied by the lowest bid price accepted for Auction Class 1 allowances at the most recent auction (see section 13 of the cap-and-trade regulation). It is unclear whether this fine would be *in place of* or *in addition to* the 3:1 allowance penalty.

MOECC should provide clarification regarding whether the fine described in section 13 replaces or is added to the 3:1 allowance penalty. Furthermore, the Ministry should consider a higher fine given that the current proposed fine is based on the lowest bid price for Auction Class 1 allowances. The key is to ensure that the penalty is meaningful and does not allow participants to avoid the 3:1 allowance penalty in place of a minor fine.

8. Early Reduction Credits

The draft regulations contain provisions that would allow certain covered emitters to apply for early action credits (effectively, credits for eligible emissions reductions that occurred between January 1, 2012 and December 31, 2015).

Section A.4.2 provides that emissions eligible for ERCs are those emissions that are:

- Reported and verified under the Reporting Regulation
- The type that would be eligible for free allocation; and
- Not emitted from a facility that is eligible for free allocation under the product output benchmark approach.

These criteria ensure that those facilities who are already awarded for early action indirectly through a benchmark approach are not awarded twice. However, this section leaves open the possibility of a facility that is already receiving 100 per cent free allowances under any of the other three allocation methods being able to apply and qualify for ERCs.

Note that California, which has already been criticized for being too generous with its allowances to industry, employs a product-output benchmarking approach to allocating allowances and does not include early reduction credits. Meanwhile, Quebec did not employ a product-output benchmarking approach to allocating allowances and instead issued one-time early reduction credits at the launch of its program. Neither jurisdiction employs both options for recognizing early action. Ontario is proposing a hybrid approach, which appears to address the concern that certain early acting facilities would be awarded twice through a benchmarking approach to free allowance allocation and the awarding of ERCs.

The CEA supports MOECC's approach to ERCs, provided that early acting facilities that receive ERCS do not also receive free allowances through a benchmark approach.

9. <u>Ministerial Discretion and Transparency</u>

The CEA indicated in previous submissions that, in Ontario's cap-and-trade program, the Ministry is awarded a high level of discretion as compared to other systems (for instance, California's system, which is administered by an arms-length body, the Air Resources Board). It is also concerned about a lack of transparency with respect to certain design elements. Here is a list of sections where these concerns may arise, in addition to those already discussed above:

- Under section 9, the Minister can remove emissions allowances and credits (ERCs or offsets) from an entity's compliance account.
- Under section 11, the Minister can remove emissions allowances and credits (ERCs or offsets) from an entity's compliance *or* holding account.
- A MOECC note under section 33 states that the Minister, at least once per year, shall post a list of registrants and a summary of transactions but does not specify what details would be included in this list (e.g. who purchased from whom; how much was paid; how many allowances were transferred, etc.)
- Section 42 provides that the Minister will publish "in a manner that the Minister considers appropriate", a written summary of each auction or sale, which would include the following information:
    - Registered participants who submitted bids in auction or sale.
    - Details regarding the number of emission allowances sold; the number of each vintage year or category; and a description of how emission allowances were distributed among participants who submitted bids, without identifying which participants purchased emission allowances.
    - In the case of auction, the lowest bid price accepted for Class 1 allowance and lowest bid price accepted for Class 2 allowance.

Sections 9, 11, 33 and 42 should be amended to include strict criteria for when the Minister can remove emissions allowances and credits from an entity's compliance or holding account. The wide discretion provided to the Minister in the regulatory proposal should be limited to prevent the opaque removal of emissions allowances and credits for political reasons, or what could be perceived as political reasons.

10. Guidance Document

Finally, in light of the highly technical and evolving nature of Ontario's cap-and-trade system, the CEA recommends that MOECC publish an easy-to-understand guidance document that provides the rationale behind each of the design elements, assists participants and other stakeholders in understanding and complying with the system, and outlines how the system will measure and report on performance.

CONCLUSION

The CEA is strongly supportive of Ontario's commitment to implement a cap-and-trade program to price carbon pollution. The regulatory proposal accompanies the strongest piece of climate legislation that Ontario has seen to date, the *Climate Change Mitigation and Low-Carbon Economy Act*. But the Act and the regulations could be further strengthened to ensure that the cap-and-trade program is as effective, predictable, stringent, fair, transparent and durable as possible. Specifically, the CEA recommends that the regulations be improved to:

- require a compliance obligation for new facilities as soon as they begin operating
- prohibit the allocation of free allowances to new facilities and voluntary participants
- provide increased clarity and transparency in the application of allocation methods for free allowances
- adopt a transparent, data-driven approach to determining which industries are energy-intensive and trade-exposed
- establish a detailed timeline for the phase-out of free allowance allocation
- provide more information to the public about the distribution, auctioning, and sale of emissions allowances
- reduce the discretionary powers allotted to the Minister of the Environment and Climate Change regarding the removal of emissions allowances and credits from an entity's holding accounts

The CEA looks forward to continuing to work with the province on the cap-and-trade program and all aspects of the climate strategy in the months ahead. If you have any questions or require any clarification on the contents of this submission, please contact:

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Appendix 1: List of Clean Economy Alliance Members

ArcTern Ventures
Asthma Society of Canada
BioFuelNet
Bioindustrial Innovation Canada
Blue Green Canada
Bullfrog Power
Canadian Association of Physicians for the Environment
Canadian Biogas Association
Canadian Solar Industries Association
Canadian Wind Energy Association
Carbonzero
Cement Association of Canada
Chrysalix Energy Venture Capital
Citizens Environment Alliance of Southwestern Ontario
Clean Air Partnership
Clean Energy Canada
Climate Reality Project Canada
CoPower
Corporate Knights
CRH Canada
Cycle Toronto
David Suzuki Foundation
The Clean 50
Delta Management
Earth Day Canada
Earth Rangers
Ecosystem Energy Services Inc.
Efficiency Capital Corporation
Energy Storage Ontario
EnviroCentre
Environmental Defence
Evergreen CityWorks
Fadco Consulting Inc.
Faith & the Common Good: Greening Sacred Spaces
Field Chemical Technologies Inc.
Forests Ontario
Green Communities Canada
Geosource Energy Inc.
Green Neighbours 21
Green Planet Biofuels
Innovolve Group
International Institute for Sustainable Development
Lafarge Canada Inc.
LED Roadway Lighting
Lumos Energy
MaRS CleanTech
Mindscape Innovations
Mountain Equipment Co-op
NAIMA Canada
Nanoleaf
NEI Investments
NRStor Inc.
Ontario Association of Architects
Ontario Clean Air Alliance
Ontario Federation of Agriculture
Ontario Lung Association
Ontario Nature
Ontario Rivers Alliance
Ontario Secondary School Teachers' Federation
Ontario Society of Professional Engineers
Ontario Sustainability Services
Ontario Sustainable Energy Association
Ontario Waterpower Association
OpenConcept Consulting Inc.
Patagonia
Perkins+Will
Petrolup
Plug n' Drive
Price Carbon Now, ON!
RainGrid
Registered Nurses' Association of Ontario
Responsible Investment Association
rethink Green: Solutions for a Sustainable Sudbury
Shareholder Association for Research & Education
Smarter Shift
St Marys Cement
Sustainability CoLab
Sustainable.TO Architecture + Building
The Pembina Institute
Terragon Environmental Technologies Inc.
Top Drawer Creative
Toronto Atmospheric Fund
Toronto Centre for Active Transportation
Toronto Cycling Think and Do Tank
Toronto Environmental Alliance
Toronto Parks and Trees Foundation
TREC Renewable Energy Cooperative
TREC Education
Unifor
United Steelworkers
Windmill Development Group, Ltd.
World Wildlife Fund Canada
Zerofootprint Software Inc.

Appendix 2: Clean Economy Alliance Six Principles of Carbon Pricing

- Ontario's cap-and-trade system must be designed so it is effective and contributes meaningfully to reaching Ontario's 2020, 2030 and 2050 emissions reduction targets

- The cap-and-trade system should apply to as large a share of Ontario's emissions as is practicably possible

- The system should be designed in a way that is fair to those who may be disproportionately impacted such as low-income families and workers

- It should be fair to companies that have taken early action, and address impacts to energy-intensive and trade-exposed industries

- The cap-and-trade system should be predictable, and be geared toward continuous improvement and increasing stringency over time.

- Revenues from cap-and-trade should be dedicated to supporting complementary policies to reduce carbon emissions and adapt to the impacts of climate change

Appendix 3: Clean Economy Alliance Cap-and-Trade Recommendations from *Getting it Right* (available for download at: http://cleaneconomyalliance.ca/getting-it-right/)

COVERAGE

Following from the principle that the cap-and-trade program should apply to as large a share of Ontario's emissions as is practicably possible, coverage in Ontario should be aligned with Quebec and California at a minimum of 85 per cent coverage of the economy, including electricity, buildings, transportation and industry. Fuels should be included in the system from the outset. No exemptions should be given.

STRINGENCY

Ontario's cap-and-trade program should be implemented by 2017 and the emissions cap should decline by approximately five megatonnes (MT) per year, on a clear and transparent schedule to provide businesses certainty. The cap needs to decline commensurate with Ontario's 2020 and 2030 targets. Consistent with the recommendations on coverage above, fuels should not be subject to delayed implementation.

PRICE STABI LIT Y

Ontario's program should include a price floor, a market stability reserve, and an allowance purchase limit. Ontario should establish an auction reserve price (acting as a price floor) that increases by five per cent per year plus inflation to align with Quebec's and California's systems. It should establish a market stability reserve (acting as a price ceiling) that holds allowances and contains clear guidelines for adding and removing allowances from the system. Lastly, it should establish an allowance purchase limit to prevent covered industries from purchasing unnecessary allowances and artificially raising the price.

OFFSETS

Ontario should limit the use of offsets to a maximum of eight per cent of an entity's total compliance obligation, consistent with California and Quebec. Offsets should be subject to high standards in terms of verification to show that they are additive and permanent.

COMPET I T IVENESS IMPACTS

Any process for assessing and addressing competitiveness impacts must be rigorous, transparent and based on sound economic analysis. If any permits are allocated without cost, they should only be granted to a very small set of industries where there is compelling evidence that there will be competitiveness challenges and leakage. Furthermore, any free allocation of permits must be transitional, decreasing consistently over time and in keeping with emissions intensity targets that also decrease consistently over time.

PROGRAM OVERSIGHT AND REVENUE ALLOCATION

The proceeds from carbon pricing should be dedicated to the Greenhouse Gas Reduction Account, per the Environmental Protection Act (2009), and disbursed according to the provisions of that legislation, including but not limited to:

- Mitigation of climate impacts on low-income and otherwise marginalized communities
- Monitoring, reporting, verification, oversight and governance, similar to the allocation of $45 million for "coordination, monitoring and accountability" in Quebec's Climate Change Action Plan

- Development and deployment of low-carbon technologies, such as renewable energy, clean technology, energy efficiency and conservation, public transit, and infrastructure for active transit, such as walking and cycling, that will support economic transformation and innovation and position Ontario to build a 21st century clean economy.

The fund should be administered by a third party in a transparent manner in order to avoid the perception of political interference and to facilitate widespread popular support. The determination of which projects receive funding should include a per dollar assessment of the GHG reduction potential of the initiative, economic analysis to ensure the proceeds deliver the greatest impact possible, and consideration of when an initiative will begin delivering emissions reductions. Ontario should also consider allocating a portion of proceeds to municipal planning authorities to develop climate change action plans to help municipalities mitigate and adapt to climate change.

LINKAGE WITH QUEBEC AND CALIFORNIA

Through the WCI, Ontario should focus on similar design details as those in California and Quebec to facilitate linkage, while making minor improvements that ensure its system is just as, or more stringent, equitable and effective than the others while accommodating Ontario's unique economy and environment.