PROPOSED AMENDMENTS TO THE CAP AND TRADE AND REPORTING REGULATIONS - SPRING 2017

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1 Introduction

This document includes policy proposals to amend Ontario's Cap and Trade Program Regulation (O. Reg. 144/16) and incorporated Methodology for the Distribution of Ontario Emission Allowances Free of Charge, dated December 12, 2016 (the Methodology). Complementary changes are also being proposed to the Quantification, Reporting and Verification of Greenhouse Gas Emissions Regulation (O. Reg. 143/16) (Reporting Regulation) and incorporated Guideline for the Quantification, Reporting and Verification of Greenhouse Gas Emissions (effective January 2017) (Reporting Guideline) to support the implementation of the Cap and Trade Program.

Following the 45-day consultation period, comments received will be considered and a decision will be made on the proposal.

Changes that the Ministry is proposing include:

- Amendments to the Methodology for the Distribution of Ontario Emission Allowances Free of Charge including:
    - Making it clear that facilities that receive indirect useful thermal energy (e.g., imported steam) and pass some of it on to other facilities will be eligible for distribution of Ontario emission allowances free of charge (free allowances) only for the portion they use.
    - Changing the Methodology applicable to particular facilities, from the energy use-based and historical absolute emissions methods to the product output benchmark or historical emissions intensity methods.
    - Modifying existing product output benchmarks and historical emissions intensities to better align with facility and sector emissions.
- Proposed technical amendments to the Guideline for the Reporting Regulation include:
    - Ensuring the compliance obligation for emissions from process fuels from iron and steel production is imposed on the iron and steel producer even in situations where the process fuels have been transferred from one facility to another facility prior to combustion and resulting emission of greenhouse gas.
    - Ensuring all emissions from the combustion of natural gas delivered to a participant with a compliance obligation (capped emitter) bear a compliance obligation. This addresses a unique situation in which no entity has a compliance obligation in respect of greenhouse gas emissions where natural gas that is delivered to a capped participant is subsequently transferred to an entity that is not subject to a compliance obligation.

The proposed shift from historical emissions or energy based distribution methods for certain facilities is consistent with ensuring the risk of carbon leakage (movement of production to jurisdictions without carbon pricing) is minimized and fairness and equity are maintained. The intent is to move all facilities to allocation methods linked to production over time.

2 Changes to the Cap and Trade Program Regulation – Ontario Regulation 144/16

- Proposed amendments to the Cap and Trade Program Regulation include:
  - Administrative amendments to improve operation and implementation of the Cap and Trade Program (e.g., address a situation where, due to increasing emissions, a facility becomes a mandatory participant after registering as a voluntary participant in a previous year).

3 Changes to the Methodology for the Distribution of Ontario Emission Allowances Free of Charge

The Ministry has consulted with stakeholders to refine the methods for distribution of free allowances. The Ministry is proposing the following changes to the Methodology to refine allowance distribution to better account for changes in production/operations, or to move from energy use method/ historical absolute method to facility intensity/product output benchmark approaches.

3.1 Safety-Kleen Canada Inc.

Safety-Kleen Canada Inc., a recycler of used oil products, is currently eligible for free allowances under the energy use method (Method B).

The Ministry is proposing that instead of the current method, Safety-Kleen Canada Inc. be eligible to receive free allowances according to Method C2 – Historical Emissions Intensity. It would be eligible to receive allowances on the basis of each kilolitre of used oil feed. “Used oil feed” means the used oil that is processed in the refinery process units at the facility to produce a base oil that is suitable for blending into lubricants meeting industry certifications. The proposed historical emissions intensity would be based on historical 2010-2014 (inclusive) total facility emissions intensity.

3.2 Pulp and Paper Industry

3.2.1 Strathcona Paper LP.

Strathcona Paper LP, a producer of recycled boxboard products, is currently eligible to receive allowances free of charge under the historical absolute emissions method (Method C1).

The Ministry is proposing that instead of the current method, Strathcona Paper LP be eligible to receive allowances under Method C2 – Historical Emissions Intensity. It would be eligible to receive these free allowances on the basis of tonnes of Coated Recycled Boxboard produced. "Coated Recycled Boxboard" means clay coated boxboard made from recovered or recycled waste paper at the facility. The proposed historical emissions intensity would be based on historical 2010-2015 (inclusive) total facility emissions intensity.

3.2.2 Irving Consumer Products

Irving Consumer Products, a producer of household tissue products, is currently eligible to receive free allowances under the historical absolute emissions method (Method C1).

The Ministry is proposing that instead of the current method, Irving Consumer Products be eligible to receive free allowances under Method C2 – Historical Emissions Intensity, to reflect changes in its products and manufacturing equipment. It would be eligible to receive free allowances:

- per tonne of tissue produced with an Light Dry Crepe (LDC) machine and
- per tonne of tissue produced with a Through Air Dried (TAD) machine

The proposed historical emissions intensity would be based on historical 2010-2012 (inclusive) emissions intensity for tissue produced with a Light Dry Crepe (LDC) machine. The proposed historical emissions intensity would be based on 2016 emissions intensity for tissue produced by the TAD machine.

3.3 Insulation Manufacturing

3.3.1 Roxul Inc.

Roxul Inc., a producer of mineral wool insulation products, is currently eligible to receive free allowances according to the historical absolute emissions method (Method C1).

The Ministry is proposing that instead of the current method, Roxul Inc. be eligible to receive free allowances according to Method C2 – Historical Emissions Intensity based on mineral wool production. "Mineral Wool" means fibers produced at the facility from a refractory furnace, with basalt rock and slag. The proposed historical emissions intensity would be based on historical 2014-2015 (inclusive) total facility emissions intensity, to reflect periods of normal operation.

3.4 Ethanol Production

3.4.1 Greenfield Specialty Alcohols (GFSA), Chatham

GFSA (Chatham), a facility that produces both fuel ethanol and industrial ethanol and also operates a cogeneration unit, is currently eligible to receive free allowances according to the historical emissions intensity method (Method C2) based on its 2010-2014 industrial and fuel ethanol production data.

The Ministry is proposing to revise the historical emissions intensity for GFSA (Chatham), taking into consideration the recent addition of an additional cogeneration unit in 2015. The Ministry is proposing that instead, GFSA (Chatham) be eligible to receive free allowances under Method C2 – Historical Emissions Intensity based on the three product parameters: 1) industrial ethanol, 2) fuel ethanol, and 3) electricity generation from cogeneration. The proposed historical emissions intensity would be based on historical 2010-2014 (inclusive) facility emissions intensities for each of the three parameters.

3.4.2 Fuel Ethanol Production

Fuel ethanol producers are currently eligible to receive free allowances under the energy use method (Method B).

The Ministry is proposing to revise the Methodology to include a product output benchmark method (Method A) for facilities that produce only fuel ethanol. The product benchmark will be based on litres of fuel ethanol produced and reported as absolute alcohol. The proposed product output benchmark would be 0.0003752 tonnes of CO2e/ litre of absolute ethanol produced, based on the weighted average historical 2010-2014 (inclusive) of emissions and production for facilities that were drying distillers' grain solids as part of the ethanol production process.

3.5 Beer Production

Beer producers are currently eligible to receive free allowances under the product output benchmark method (Method A). This benchmark was based on sector emissions intensity, with beer as the product. Some facilities in the sector also have emissions associated with cogeneration. The Ministry is proposing to revise the sector benchmark to address the additional emissions from onsite cogeneration in the sector.

The Ministry is proposing that instead, the beer producers would be eligible to receive free allowances based on two product parameters: 1) beer; and 2) electricity generated from cogeneration.

The proposed product output benchmark would be based on the weighted average historical 2010-2014 (inclusive) of emissions and production for facilities that manufacture beer, taking into consideration emissions from cogeneration. The proposed benchmark for electricity generation will be 0.2219 allowances for each MWh of electricity generated (which is the same as the $EF_{bilateral}$ under Method F).

3.6 2017 Production Adjustment Allowances

With the fall 2016 amendments to the Methodology, voluntary participants with combined Indirect Useful Thermal Energy and direct emissions over 10,000 tonnes are eligible to receive free allowances for the year 2017 through the production adjustment (i.e., an adjustment to allocations for future years once actual data that were the basis for past years' allocations are known).

However, voluntary participants that increase direct emissions to more than 10,000 tonnes in 2016 are currently not eligible to receive free allowances for the year 2017. The Ministry is proposing revisions to the Methodology to allow such voluntary participants to receive allowances related to these emissions for the year 2017.

3.7 Indirect Useful Thermal Energy (IUTE) Transfers

Indirect Useful Thermal Energy means thermal energy that is received by one facility and generated at another. Facilities receiving IUTE are currently eligible to receive free allowances

under the IUTE method (Method E) based on the amount of IUTE that is used at the facility but generated at another facility.

The Ministry is proposing to revise and clarify Method E as follows:

- The calculation of allowances under Method E will be based on the IUTE that a facility receives less any IUTE that is transferred out of the facility.
- A facility that is receiving IUTE from a facility that is passing through some or all of the IUTE that it receives (from a third facility that generated the IUTE) would be eligible to apply for free allowances under Method E;
    - The maximum value of IUTE used in the calculation for a facility applying for free allowances would not be permitted to be greater than the IUTE that is first received from the facility that produced and transferred the thermal energy.

4 Changes to the Quantification, Reporting and Verification of Greenhouse Gas Emissions – Ontario Regulation 143/16

4.1 Process Fuels from Iron and Steel Production

Process fuels, such as coke oven gas and blast furnace gas, are generated from the production of coke (in coke ovens) and iron (in blast furnaces) at an integrated iron and steel production facility. Under the current Reporting Regulation, when the process fuels are transferred from the facility, the responsibility for reporting the emissions is imposed on the facility that receives the process fuel. However, under the current provisions of the Cap and Trade Program Regulation, the iron and steel producer is the facility that is eligible to apply for free allowances in respect of the process fuels.

The Ministry proposes to amend the Reporting Guideline and Regulation to require the reporting of emissions from the use of all the process fuels by the iron and steel producer, including emissions associated with any process fuel that is transferred off-site.

The current for the distribution of free allowances to iron and steel producers for coke making and iron making would continue.

Iron and steel producers would, as a result of the proposed changes, have compliance obligations for emissions from the use of all the process fuels, including emissions associated with the process fuel that is transferred off-site. This would ensure that the cap and trade compliance obligation associated with the greenhouse gases due to use of process gases falls on the recipient of free allowances allocated in respect of those production gases.

4.2 Indirect Natural Gas Supply

Currently, a natural gas utility is not required to report the emissions for natural gas distributed to a capped participant, and hence would not impose a carbon cost in respect of that volume of natural

gas (e.g., volume measured at the capped emitter's gas meter). It has recently been brought to the Ministry's attention that there are unique cases where natural gas distributed to a capped participant is being transferred to a non-capped participant. This volume of natural gas that is transferred to a non-capped entity is not captured by the program (i.e., no facility has a compliance obligation in respect of the emissions from the combustion of that gas). To address this situation, the Ministry is proposing to require a capped participant to report emissions for:

a. Natural gas used at its own facility; and
b. Natural gas delivered to a capped participant that is transferred offsite to a non-capped entity (e.g., the volume that is part of the amount measured at the capped participant's gas meter used for billing by the natural gas utility).

The capped participant would bear a compliance obligation for the emissions from this gas and other emissions that they report and verify under the Reporting Regulation.

The capped participant would not have to report or verify emissions for natural gas transferred offsite to another capped participant.

5 Changes to the Guideline for Quantification, Reporting and Verification of Greenhouse Gas Emissions

5.1 Verification Amendments

Currently, the Reporting Regulation requires verification of the total production quantity at a facility. The production quantity is primarily relevant to an application for free allowances (the production parameters are identified in the Methodology). Under the current rules:

1. Production data or production parameter is generally defined in the Guideline;
2. Verification of only the total production quantity is required.

The Ministry is proposing to amend the Reporting Regulation and Guideline to create a better connection between reporting and verification of production data/production parameters and the Methodology. The proposal is to adjust the verification requirement as follows:

1. Production data would only be required to be reported for production parameters that are an input to the formula for the distribution of allowances free of charge (e.g., identified in the Methodology).
2. Individual verification determinations would be required for each production parameter that is necessary for an application for the distribution of allowances free of charge (instead of verification of the total aggregated production quantity);
3. There would be two parts to a verification statement, as follows:
    a) A verification finding for the verified emissions;

b) Verification finding for each parameter that is required to be included in any application for the distribution of allowances free of charge under the Cap and Trade Program Regulation.

5.2 Guideline Amendments

Additional changes to the Reporting Guideline are proposed as follows:

1. Complementary changes to support the changes related to process fuels from the iron and steel sector, and natural gas that is transferred offsite by a capped participant to a non-capped entity;
2. Clarification that petroleum product supplied into Ontario only has a compliance obligation if it is used in Ontario;
3. Clarification and clear identification of product parameters, consistent with changes identified in section 5.1 above;
4. Clarification that electricity imported as unspecified electricity from Pennsylvania-New Jersey-Maryland Interconnection balancing authority should have an adjustment factor (AF) in ON.66 equal to one.