

**PROPOSED AMENDMENTS TO  
THE CAP AND TRADE  
PROGRAM AND REPORTING  
REGULATIONS & PROPOSED  
SERVICE REGULATION**

**September 22, 2017**

Proposed Amendments to the Cap and Trade Program and Reporting Regulations & Proposed Service Regulation  
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## Introduction

Climate change is a global problem that requires taking collective action. Ontario, Quebec and California have worked together since 2007 to develop a regional program design that will reduce greenhouse gas emissions and spur the development of clean technology. When Ontario decided to establish a cap and trade program as the primary mechanism for addressing climate change, it indicated its intent to link with the cap and trade programs of California and Quebec in 2018. This decision was based on third party economic modelling, which shows that linking Ontario's cap and trade program with California and Quebec would help Ontario meet its greenhouse gas emission reduction targets at the lowest cost.

The Ministry of the Environment and Climate Change (MOECC) is now proceeding with a proposal that includes the necessary regulatory amendments to link its cap and trade program with the cap and trade programs of California and Quebec starting January 1, 2018.

The MOECC is also proposing to make several additional amendments to the cap and trade program aimed at providing clarity to stakeholders, as well as providing fair and equitable treatment among participants. These amendments include:

- The establishment of emission caps for the years 2021 to 2030. Extending the emission caps will help provide more certainty to both the regulated community and the market, and allow the government to continue offering advance auctions in 2018.
- A number of amendments to the existing program regulations aimed at providing fair and equitable treatment. This includes administrative amendments to improve data reliability and program efficiency.

Each of the policies proposed above affect changes to the core regulatory pieces of Ontario's cap and trade program including:

- The Cap and Trade Program Regulation, O. Reg. 144/16 (Cap and Trade Regulation) and incorporated Methodology for the Distribution of Ontario Emission Allowances Free of Charge, dated July 2017 (the Methodology).
- 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 (dated July 2017) (Reporting Guideline).

The following sections discuss the specifics of each proposal in more detail to inform your feedback to the Ministry. Following the 45-day consultation period, the Ministry will consider comments received and decide on the proposal.

In addition to the amendments outlined in this document, the Ministry is proposing a new service of documents regulation under the Climate Change Mitigation and Low-carbon Economy Act, 2016 (CCMLEA) to provide the regulated community with certainty and clarity as to how documents can be given or served under the Act. This includes the method of giving or serving documents (e.g., by courier, email or fax), the individuals who may be given or served a document (e.g., individuals, types of businesses, Directors appointed under the Act, the Minister of Environment and Climate Change) as well as requirements on the deemed day of service. This would be similar to the service of documents regulations found under the Environmental Protection, Safe Drinking Water, Pesticides, Nutrient Management, Clean Water, and Ontario Water Resources Acts.

## Linking with Quebec and California

The Cap and Trade Regulation will require a number of changes to provide for the linking of Ontario's program with the joint Quebec-California program. These include:

- Recognizing compliance instruments from California and Quebec so these may be used to meet compliance obligations in Ontario, and to make them eligible for trading in the market by Ontario participants;
- Holding joint auctions of emission allowances with California and Quebec;
- Adjusting holding limits for allowances and credits and purchase limits for allowances to account for linking of all three jurisdictions;
- Requiring related persons in Ontario to share holding and purchase limits with related persons in California and Quebec; and
- Allowing some entities to register in more than one jurisdiction.

### Note

The Ministry will likely need to make complementary amendments to other provisions to give effect to the above policies. This could include cross-referencing, using consistent terminology, providing clarity (e.g., concerning compliance and enforcement provisions for traded instruments), and aligning with California and Quebec where it is necessary to be identical.

Similar amendments would be needed in California and Quebec in order to give effect to linking. This includes recognizing Ontario compliance instruments and allowing Ontario participants to purchase and trade California and Quebec compliance instruments.

As part of this process, the Ministry will be considering changes to the circumstances under which the Director may cancel the registration of a voluntary or market participant in order to enhance protection of market integrity. For example, following a conviction of a serious offence under the Commodity Futures Act, or Securities Act.

## Timing for Linking of Programs

The Ministry is proposing that Ontario's cap and trade program joins the California-Quebec joint program effective January 1, 2018. On this date, allowances and credits from all jurisdictions will be completely fungible. This means Ontario registered participants will be able to purchase allowances and credits from registered participants in Quebec and California or from joint auctions held by Ontario, California and Quebec, and subsequently submit these allowances and credits to meet compliance obligations in Ontario. Conversely, registered participants in California and Quebec will be able to do the same with Ontario allowances and credits once similar amendments are in effect in Quebec and California, as is planned.

## Recognition of Compliance Instruments from California and Quebec

The Ministry is proposing to recognize the compliance instruments from California and Quebec, identified in Table 1 below, by prescribing these instruments in the regulation. By prescribing California and Quebec instruments in regulation, Ontario participants would be able to purchase or sell these compliance instruments along with Ontario's. Participants in California and Quebec will be able to do the same with Ontario allowances and credits once Quebec and California make similar amendments to their regulations, as is planned.

Table 1: Acceptable Compliance Instruments from California and Quebec

Designated Jurisdiction	Compliance Instrument	Equivalency
Quebec	Greenhouse Gas Emission Unit	One tonne of CO <sub>2</sub> e
	Reserve Emission Unit (issued for free)	One tonne of CO <sub>2</sub> e
	Offset Credit	One tonne of CO <sub>2</sub> e
	Early Reduction Credit	One tonne of CO <sub>2</sub> e
California	California GHG Allowance	One tonne of CO <sub>2</sub> e
	ARB Offset Credit	One tonne of CO <sub>2</sub> e

In addition to recognizing these compliance instruments, the ministry will also allow Ontario capped emitters to submit these instruments to comply with their compliance obligations under section 14 of the *Climate Change Mitigation and Low-carbon Economy Act, 2016* (CCMLEA).

The ministry is proposing to treat emission allowances and credits from other jurisdictions similarly to Ontario instruments when removed from accounts of registered participants by the Minister for compliance purposes in the regulation. For example, emission allowances from California and Quebec will be removed irrespective of jurisdictional origin and according to the same algorithm applied to Ontario emission allowances, e.g., for removal of instruments for meeting the November 1 compliance deadline of section 11(1).

To support changes regarding the recognition and use of these instruments, the Ministry will need to adjust provisions in the regulation, including adding new terms or definitions, to distinguish between allowances or credits created by designated jurisdictions or allowances and credits created by the Minister in Ontario. These provisions will also clarify obligations for Ontario entities related to the purchase of offset credits created by California.

California's regulation places an obligation on the purchaser of offset credits created in California to replace those credits in the event they are invalidated. The entity holding the credits at the time of invalidation (or the entity that surrendered them for compliance purposes) maintains this obligation for a specified period of time. Ontario's Cap and Trade Regulation will recognize this obligation and identify the process to support the replacement of invalidated California offset credits held by Ontario entities.

MOECC also intends to clarify compliance and enforcement rules with regard to allowances and credits from California and Quebec.

## Joint Auctions

### Minimum Price

Currently, the minimum price, also commonly known as the auction reserve price, is set based on the most recent WCI joint auction reserve price, converted into Canadian dollars on the day of Ontario's auction. In joining the linked market there would be a single common price used by all jurisdictions participating in the joint auction. To enable this, the Ministry is proposing to change its auction reserve price to align with the process detailed below.

On an annual basis, as is done in Quebec and California, Ontario will raise its auction reserve price by 5% plus changes in its Consumer Price Index. On the day of each joint auction, the auction reserve price will be set at the

highest reserve price from all jurisdictions, applying the Canadian dollar exchange rate published by the Bank of Canada on the previous day. If the Bank of Canada did not publish an exchange rate on the previous day, then the Ministry will use the most recent exchange rate published by the Bank of Canada prior to the date of the auction.

The Ministry is proposing to calculate Ontario's annual minimum price using the following formula:

$$MP_t = MP_{t-1} \times (1 + 0.05 + Ir)$$

Where:

$MP_t$  = Ontario's auction reserve price for year  $t$

$Ir$  = the percentage change (expressed as a fraction) in average Consumer Price Index for Ontario for the 12-month period ending on September 30 of  $t-1$ , from the preceding corresponding 12-month period, as published by Statistics Canada under the Statistics Act (Canada).

The Ministry is proposing to make other complementary amendments needed to enable joint auctions, including:

- Issuing joint notices for joint auctions;
- Allowing eligible bidders from California and Quebec to purchase Ontario allowances at joint auctions; and
- Allowing for payment for allowances in U.S. dollars.

In joint auctions, each lot of a thousand allowances offered for sale would include allowances from Quebec, California and Ontario.

Additionally, some terminology in the regulation may need to be adjusted in order to align with terminology in California and Quebec or terminology used in the auction platform to ensure clarity.

## Related Persons

Related persons are defined in the cap and trade program based on business relationships, common account representatives who are employees, and share of control of the business. Currently, under the cap and trade program, registered participants who are related persons must share holding and purchase limits. To maintain market integrity once the programs are linked, these requirements would need to be extended to related persons who are registered in California and Quebec.

The Ministry is proposing to amend the Cap and Trade Regulation to require registered participants to share the holding and purchase limits with related participants registered in Quebec and California and to provide information on the nature of their relationship in accordance with Schedule I of the Cap and Trade Regulation.

Registered participants would need to provide the Ministry with any updated information on business relationships with registered participants in California and Quebec no later than 40 days before the day of the first joint auction. These updates would be required by all participants who have related persons in California or Quebec, regardless of the participant's intention to participate in the first joint auction.

Notwithstanding these deadlines, MOECC requests that registered participants provide this information as soon as possible so that necessary updates to participants' accounts can be completed promptly.

Changes to the Cap and Trade Regulation, including the use of new terms, will be necessary to identify capped participants and market participants in other jurisdictions where there are interactions.

## Same Entity with Multiple Capped Participants are Related Persons

MOECC is proposing to treat mandatory and voluntary participants that have registered in Ontario’s program that are also registered as a capped participant in either California or Quebec as related persons. This means that they would be required to share holding and purchase limits.

## Clarifying Related Persons

The Ministry is proposing to make it clear that related persons who have a common related person are also related persons. Specifically, if a first person (participant) has a related person business relationship as described in Section 2 (2) of the Cap and Trade Regulation with a second person, then that first person is also a related person with any registered entity to whom the second person is a related person.

For example, Person A owns 60 percent of the securities of Person B and Person B owns 70 percent of the securities of the Person C. All three of the entities are registered. Under the proposed amendments, Person A and Person C would be related persons regardless of which of the three jurisdictions in which they are registered.

## Holding and Purchase Limits

### Holding Limit

The current holding limits established by the formulas in section 40 of the Cap and Trade Regulation for current vintage allowances and section 42 for future vintage allowances in the Cap and Trade Regulation are based on the size of Ontario’s annual cap.

To account for the size of a linked market, the Ministry is proposing to adjust the holding limit formulas to include the combined amount of the annual caps from Ontario, California and Quebec for each year. This will raise the holding limits for current vintage and future vintage allowances as set out in Table 2.

Holding limits would also be revised to reflect the updated related persons information outlined in section 2.4 of this proposal.

Table 2: Holding Limits for a Linked Program

<b>Calendar Year</b>	<b>Current Vintage Holding Limits</b>	<b>Future Vintage Holding Limits</b>
2018	15,717,500 for emission allowances with vintage years 2018 and earlier	15,217,650 for emission allowances with a vintage year of 2019 14,715,200 for emission allowances with a vintage year of 2020 Additional limit for emission allowances with a vintage year of 2021*
2019	15,217,650 for emission allowances with vintage years 2019 and earlier	14,715,200 for emission allowances with a vintage year of 2020 Additional limits for emission allowances with vintage years of 2021 and 2022*
2020	14,715,200 for emission allowances with vintage years 2020 and earlier	Additional limits for emission allowances with vintage years of 2021, 2022, and 2023*

\* To be determined once each jurisdiction in the linked market has finalized emissions caps for years post-2020

Per the existing program rules, all participants should note the requirement to ensure that their allowance holdings do not exceed the current vintage holding limit in the year when a future vintage allowance becomes a current vintage allowance. For example, in 2018, current vintage allowances (2018 and earlier) would be subject to the current vintage holding limit of 15,717,500, and 2020 vintage allowances would be subject to a separate future vintage holding limit of 14,715,200. In 2020, these latter allowances are no longer a future vintage and count towards the current vintage holding limit of 14,715,200 for allowances from 2020 and earlier. The ministry is not proposing to change these requirements.

### Purchase Limit

Currently, capped participants are limited to purchasing up to 25 per cent of the total number of allowances offered for sale at a stand-alone Ontario auction. Market participants are limited to four per cent. The absolute value of these limits would change under a linked market, as the 25 per cent would be applied to the total number of allowances offered at a joint auction by Ontario, California and Quebec.

The effect of this amendment increases the number of allowances that an Ontario registered participant or a group of related persons of that participant may be eligible to buy at an auction.

Purchase limits would also be revised to reflect the updated related persons information outlined in section 2.4 of this proposal.

## **Allowing Registration in Multiple Jurisdictions**

In a linked program, it is possible for some participants to have compliance obligations in more than one jurisdiction (for example by virtue of ownership of multiple facilities by the same company). The Ministry is proposing to amend the Cap and Trade Regulation to allow capped participants to register in multiple jurisdictions so they can meet all of their compliance obligations in each jurisdiction.

Market participants may only be registered in one jurisdiction. As such, market participants who are registered in multiple jurisdictions will be required to select which registration(s) will be withdrawn upon linking.

However, market participants that also register to be offset sponsors would be allowed to register in multiple jurisdictions, as they may have offset initiatives in multiple jurisdictions.

To support registration in multiple jurisdictions, the ministry is proposing to share registration information across jurisdictions upon request by the participant. Registration requirements for each jurisdiction would continue to apply. The sharing of registration information between jurisdictions is intended to streamline the registration process and reduce duplication, not to replace the application process.

Market participants required to consolidate their registrations into a single market participant account would be required to transfer all allowances to their remaining account within the timelines outlined in section 2.4, and to submit a request to the appropriate jurisdiction to cancel the other market participant registration.

## **Amendments to Support Fairness and Equity**

### **Treatment of Non-Combustion Process Emissions for Voluntary Participants**

Currently, the allocation of allowances free of charge to voluntary participants is mostly based on the energy use-based allocation method. This method does not provide allowances for non-combustion related emissions (e.g., fixed process emissions) for which the participants bear a compliance obligation. The current approach treats these capped emitters differently than other capped emitters who do receive allowances free-of-charge for fixed process emissions.

The ministry will consult in the Fall with affected facilities on developing an approach that would provide allowances free-of-charge on account of non-combustion related emissions.

### **Distribution of Allowances Free-of-Charge for Certain Industrial Users of Electricity from Cogeneration**

Certain customers of a regional cogeneration system in the Sarnia area are currently paying for the natural gas (including a carbon price) that is used to generate electricity, which is then transferred to the IESO-controlled grid. These customers then purchase all their electricity from the IESO controlled grid. These customers are also capped facilities, but they are not eligible to receive free allowances for the electricity that they purchase from the IESO grid since it is not transferred directly from the regional cogeneration system to the customer's facility.

To support equitable treatment of participants, the Ministry is considering providing free allowances to these capped facilities that are customers of this regional cogeneration system in the Sarnia area and possibly imposing a direct compliance obligation on them for emissions from the natural gas used in the cogeneration system. This proposed amendment would be specific to these customers of the cogeneration system in the Sarnia area.

## **Amendments to Improve Accuracy and Program Efficiency**

### **Verification Amendments**

The Ministry is proposing amendments to the Reporting Regulation requiring reporters to submit verification reports. These reports are important for the purposes of compliance, and for supporting applications for free allowances. The verification report prepared in accordance with section 33 of the Reporting Regulation will be required to be submitted along with the verification statement.

These verification reports are critical for the review of the emissions reports by the Ministry. Without these proposed changes, it is likely that the Ministry would need to make requests to facilities to submit these reports – and the facilities would then need to comply with the request.

This change will reduce the administrative burden for the Ministry to individually request these verification reports, and the companies to comply with the requests. The proposed change would streamline the submission of the verification reports and facilitate the review of the emission reports by the Ministry.

## **Changing the Date for Applying for Allowances and for the Transfer of Allowances Distributed Free-of-Charge**

The Ministry currently transfers allowances free of charge at the beginning of the year for the following 12 months, including the allowances that are based on the production adjustment provisions (under Section 3.2 of the Methodology)<sup>1</sup>.

The requirement to submit compliance instruments in an amount equal to emissions (true up) for the compliance period takes place in November of the year following the compliance period (e.g., November 1, 2021 for the first compliance period of 2017-2020).

Under current rules, the transfer of production adjustment allowances for 2020 would occur on January 15<sup>th</sup> 2022, which would mean they would not be available to be used in the true-up on November 1, 2021.

The Ministry is proposing to change the deadline for the transfer of allowances distributed free of charge for only the second year following the compliance period (e.g., change from January 15, 2022 to October 25, 2021 for allocating allowances for 2022). The ministry will consider whether other adjustments to submission deadlines for the 2021 year are needed to facilitate processing of allowances free of charge for delivery by October 25<sup>th</sup>.

Providing allowances before the true-up deadline would allow capped facilities to use production adjustment allowances (i.e., allowances that reflect changes in production) for compliance purposes.

For the other years in the compliance period, the timeline for the distribution of free allowances would remain the same.

The Ministry is also proposing to change the deadline of September 1 for submitting an application for free allowances by up to four weeks (i.e., to no later than October 1) effective for the 2018 application year for 2019 allowances, and all following years. This will provide the regulated community with additional time to submit an application for free allowances, and for new voluntary participants to complete their registration in the cap and trade program.

## **Deadline for Registration of Voluntary Participants**

The Ministry is proposing amendments to the Cap and Trade Regulation that would require voluntary participants to register by September 1 of the year they intend to apply to participate in the program. This would provide certainty and clarity to the regulated community on when voluntary participant registration is required and would provide an opportunity for these participants to apply for allowances free of charge by the revised deadline of October 1 proposed in section 4.2 above.

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<sup>1</sup> Production adjustment allowances are intended to account for the difference between the estimated production (or energy use based on historical values) and the actual production (or energy use) that are used to calculate the free allowances. Historical production data are used initially to calculate allowances for the future year. If the actual production is higher than the estimated production, then additional allowances will be provided through the production adjustment provisions. On the other hand, if the actual production is lower than the estimated production, then allowances will be reduced for the year.

## 2021-2030 Caps under the Program

The Ministry is proposing to establish caps for the years 2021 to 2030, to provide greater long-term policy certainty and to enable the continued auctioning of future vintage allowances into 2018 and beyond.

The Ministry proposes to set the 2030 cap using a method similar to that used for the first compliance period. Using this approach, the 2030 cap will be set at a level to facilitate the achievement of Ontario's 2030 GHG target under Section 6(1) of the *Climate Change Mitigation and Low-carbon Economy Act, 2016* (37% below 1990 levels) once emissions not covered by the cap and trade program and emissions from electricity importation have been taken into account.

Ontario's emission reduction targets under the Act apply to all emissions in Ontario, including emissions not covered by the cap and trade program. This means that the cap level in 2030 must be set with regard to these uncovered emissions to ensure that Ontario's total emissions (covered and uncovered) achieve the province's emissions reduction target<sup>2</sup>.

The caps must also consider emissions from generation of imported electricity, which are covered under Ontario's cap and trade program, but are not included for the purposes of Ontario's emission reduction targets. Emissions from imported electricity are excluded from the assessment of the province's emission reduction targets because these emissions occur outside of the province.

The final regulatory amendments will set annual caps to 2030 based on Ontario's 2020 cap, declining at a constant annual rate to the 2030 cap, while taking anticipated emissions from electricity importation into account.

Given the longer period of time to achieve the required reductions, relative to the first compliance period, the annual rate of decline is anticipated to be lower between 2021-2030 than during the first compliance period. Achieving Ontario's 2020 target requires an approximate 10 per cent reduction in total provincial emissions in the first compliance period (2017 – 2020). Achieving Ontario's 2030 target will require a further reduction of approximately 26 percent from 2021 to 2030.

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<sup>2</sup> Once compliance instruments that are traded amongst the participants in the linked jurisdictions are taken into account.