Proposed Regulatory Amendments for Emissions Performance Standards Program 2023-2030

IETA Submission to Ontario's Ministry of the Environment, Conservation and Parks

7 October 2022

The **International Emissions Trading Association (IETA)** welcomes this opportunity to provide input as requested by Ontario's Ministry of the Environment, Conservation and Parks **(MECP)** in its proposal of Ontario's Emissions Performance Standards **(EPS)** program regulatory amendments for the 2023-2030 period. We view several components of the proposal to be problematic, most notably the continued exclusion of offsets and other flexible compliance options (including federal/provincial surplus credits) for EPS compliance. **Simply put, the province's failure to include compliance offsets for post-2022 EPS compliance will leave Ontario businesses worse off than their counterparts subject to federal and other provincial greenhouse gas (GHG) regulatory regimes.**

For over 20 years, IETA has been the leading global business voice on robust market solutions to tackle climate change while driving clean finance at scale. Our non-profit organization represents over 250 companies, including many with major operations, large-scale investment and work forces across Ontario and Canada's largest global trade partners. IETA's expertise is regularly called-upon to inform carbon market solutions that deliver cost-effective and measurable climate outcomes, address economic competitiveness concerns, balance efficiencies with social equity, and support a just transition.

IETA has worked tirelessly to engage provincial leadership on Ontario's climate policy over the years. As our community has communicated numerous times to the Ministry since 2019,[1] compliance offsets are an essential, results-based cost-containment and clean finance tool for any functional greenhouse gas emissions reduction program for large emitters. **We strongly urge the Government of Ontario to amend the existing EPS framework to allow compliance offsets and additionally explore expanded inter-provincial credit trading opportunities for post-2022 EPS compliance.**

IETA's input is structured around three main sections:

- **Section 1** features high-level priority input discussing the problematic exclusion of offsets for post-2022 EPS compliance;
- **Section 2** contains more detailed input associated with specific provisions of the EPS proposed regulatory amendments; and
- **Section 3** provides detailed input on EPS design elements/considerations additional to those raised in the proposed regulatory amendments.

[1] See IETA's Comments on ERO #019-2813 (January 2021) & IETA's Comments on ERO #019-3719 (July 2021)

SECTION 1: RISKS OF EXCLUDING OFFSETS FOR EPS COMPLIANCE

We consider it highly problematic that Ontario's current EPS regulation, as well as the current proposed amendments, entirely exclude the use of offsets for compliance by Ontario facilities. Given the extensive stakeholder support in favour of EPS compliance offsets,[2] **IETA questions why MECP has failed to take meaningful action to include offsets under the program?** We specifically request the Government to directly address and provide transparent rationale and justification on its continued direction to exclude offsets and modeled impacts with this approach.

IETA understands various constraints imposed by Canada's updated benchmark criteria. This includes the notable challenge of balancing credit supply (including offsets) to secure a strong marginal price signal necessary to retain/maintain federal equivalency post-2022. While not directly reflected in MECP's EPS proposal, IETA understands the concern that program stringency would likely need to be adjusted upward to enable the inclusion of offsets for compliance with the EPS program. IETA believes that sacrificing the climate (and co-benefits) and flexibility of a compliance offset market is an unnecessarily high price to pay to avoid increasing performance standard stringency**.** We hold that the potential advantages of lowered stringency awarded by the exclusion of offsets will be significantly less beneficial to Ontario in comparison to a dynamic and linkable compliance offset program.

Ultimately, failing to include offsets for post-2022 compliance would send a strong signal that Ontario is not well-positioned to achieve emissions reductions more efficiently than the Federal OBPS, raising serious competitiveness concerns for the province's industry.

High-integrity offsets provide a much-needed lower-cost compliance option that can significantly minimize competitiveness and leakage risks for emitters, like those regulated under the EPS. Excluding offsets from the final EPS will continue to place Ontario businesses at a disadvantage compared to other Canadian competitors who are operating and complying in other Canadian jurisdictions (including federal backstop jurisdictions) that have access to lower-cost compliance mechanisms. **Finally, but importantly: insufficient offset infrastructure will inhibit the province's ability to participate in, and benefit from, rapidly growing international carbon market opportunities and developments**.[3]

Please see Annexes 1 and 2 for additional information regarding the problematic exclusion of compliance offsets under the EPS. **Annex 1** provides a deeper dive into the benefits of compliance offsets for the province and explores relevant crediting opportunities and demand sources; **Annex 2** provides two recommended pathways to support the efficient implementation of a compliance offset program for post-2022 periods.

Section 1.2 Expanded Inter-Provincial Harmonization and Cooperation

[2] "A majority of stakeholders support the use of carbon offsets for compliance in the EPS program." Source(s): https://ero.ontario.ca/notice/019-2813 & https://ero.ontario.ca/notice/019-3719

[3] Today, over 60 (60) federal/regional/subnational government-mandated greenhouse gas emissions trading systems exist or are under active development. The majority of these trading systems, located across North America, Asia-Pacific and Latin America, prominently feature offsets as legitimate tools for compliance purposes as well as to enable market linkage(s) and fungibility across other systems/jurisdictions, and many of these are Canada/Ontario's largest trading partners

In addition to allowing for use of offsets under the EPS, we believe that Ontario should take further action to allow use of Recognized Units (RUs) and transfer of surplus credits from the Federal OBPS to the EPS.

This transfer would enable cost-containment, effectively addressing inter-provincial leakage concerns while unlocking additional efficiencies awarded through a broader market. The benefits from this cooperation are clear: the more extensive and broader the market, the wider the range of abatement opportunities and improved efficiencies. Similar to the benefits of offsets, Federal RUs and surplus credits would present Ontario emitters with much needed lower-cost mitigation options, supporting an EPS that would be fair, cost-effective, and flexible to the needs and circumstances of the province.

Ideally, Ontario will eventually allow EPS Emissions Performance Units (EPUs) and Excess Emissions Units (EEUs) to also be fungible with other OBS markets towards enabling full linkage with a strong single price signal across both federal and provincial systems through 2030.

An important starting point to achieve program harmonization will be development of Ontario's EPS compliance unit registry. **When designing a compliance unit registry, MECP should lean on the lessons learned from existing Canadian registries, including the Federal Credit and Tracking System (CATS).** Past lessons will allow Ontario to more easily develop a functioning registry that aligns with current best practices. Aligning with current Canadian systems will place Ontario in an excellent position to accommodate future inter-Canadian and potentially international linkages.

SECTION 2: DETAILED INPUT ON SPECIFIC PROPOSED DESIGN ELEMENTS

6.1 Fossil Fuel Electricity Generation Performance Standard:

IETA is concerned by MECP's proposed reduction to the Fossil Fuel Electricity Generation Performance Standard from 370 tC02e/GWh to 310 tC02e/GWh, starting in 2023. The proposed sudden ratcheting of the electricity benchmark risks unintended shocks to system affordability and raises carbon leakage concerns. Reductions to the electricity benchmark should aim to align with expected timelines for technological improvement to support the development of new technology and unlock more cost-effective mitigation options. IETA recommends MECP reduce the electricity benchmark gradually to 310 tCO2e/GWh by 2030.

Further, we recommend that the EPS be amended to cover GHG emissions from Ontario electricity imports. Future imported emissions should be charged the same as Ontario-produced electricity to ensure provincial competitiveness and reduce carbon leakage concerns.

7.0 Stringency Factors:

We appreciate that MECP has provided a clear long-term reduction pathway for the proposed Stringency Factors and has clarified that the required reductions will cover both non-fixed process emissions and process emissions. **The province must ensure that the proposed Stringency Factors for the 2023-2030 period are sufficiently stringent to achieve federal equivalency**.

IETA is troubled by MECP's proposed solution to addressing leakage concerns by imposing lower costs (compared to Federal OBPS), driven by less-stringent Stringency Factors. **This line of thinking is short-sighted and fails to account for cost savings unlocked with additional market flexibilities not awarded under the EPS**, such as federal compliance offsets and RUs. Despite acknowledging that "carbon leakage is driven by uneven costs … between jurisdictions due to differing environmental policies", it is concerning that **MECP has proposed amendments promoting greater price disparities to position the province favorably**. **We argue this line of thinking is flawed because it fails to address – and in fact worsens – the underlying drivers of carbon leakage.**

To reiterate, the most efficient way to ensure that carbon leakage does not occur is through aligned carbon market cooperation. **Rather than problematically promoting price disparities, we suggest MECP adjust course and consider regulatory amendments to push for greater market design alignment with federal and provincial counterparts**. Closer alignment with the Federal OBPS and other provincial carbon pricing systems will address leakage concerns while enabling increased efficiencies and unlocking lower cost mitigation options through broader market access.

9.1 Carbon Capture, Utilization and Storage (CCUS):

IETA is pleased to see the recognition of CCUS in the EPS proposal. The significant support for CCUS within Canada and amongst our key trade partners (most prominently the United States, with the recent Inflation Reduction Act) should be monitored closely and leveraged by MECP to position the province as a technology innovation hub. **We would support further action from MECP to provide incentives and drive CO2 utilization as a technology and production development objective for Ontario.**

We find that MECP's proposal (i.e., to only recognize CO2 emissions that are captured at a covered facility and stored permanently as GHG reductions at the covered facility) falls short of the regime needed to make CCUS a useful mitigation strategy in Ontario.

The limitation to geological storage for CO2 suggested in the proposal is short-sighted, as revenue unlocked through the utilization of captured CO2 is a key building block to support a CCUS system. We note that restricting CCUS activities to geological storage would position Ontario behind provincial counterparts, including Alberta, which recognizes CCUS for storage and enhanced oil recovery activities. Moreover, limiting the incentive of CCUS to covered facilities will exclude many small and medium-sized enterprises in Ontario from the benefits of carbon sequestration if they are not covered in the EPS system.

As written, it is unclear how CCUS reductions achieved beyond a facility's GHG Emissions Limit would be recognized under the EPS. **IETA recommends that MECP enable CCUS activities that result in reductions beyond the reporting facility's GHG Emissions Limit to be recognized as EPUs.** Additionally, we recommend that CCUS reductions should not be restricted for compliance use solely towards the capturing facility's benchmark. Instead, CCUS reductions should be eligible for compliance towards any large emitting facility owned by the reporting company. Enabling a credit mechanism would better serve to address these concerns and efficiently award value back to the sites of carbon capture within the province.

Finally, **we stress the importance for MECP to align Ontario's future EPS CCUS approach – including terminology - with the federal system(s) and how these are evolving across key trade partners.**

SECTION 3: ADDITIONAL COMMENTS TO INFORM EPS PROGRAM REVIEW

Model Assumptions:

MECP should dramatically improve transparency on model inputs/assumptions guiding the proposed regulatory amendments. Specifically, we seek further insights into model results justifying the exclusion of offsets and other tradable GHG credits for compliance by covered entities, as well as results indicating the expected environmental impacts that would result from a lower price being imposed (as compared to the Federal OBPS).

Many affected Ontario businesses lack a clear line of sight into MECP's core EPS modeling data and information, which is being used to inform major program modifications.

MECP claims that the EPS program is expected to lower costs over the Federal OBPS by a present value of $1.1 billion cumulatively over 2023-2030. Where is the data and evidence supporting this claim? Absent a more transparent regulatory cost and impact analysis, it is unclear how this conclusion was reached. As such, IETA urges MECP to release further clarification regarding the assumptions guiding the regulatory impact assessment as soon as possible and prior to finalizing the EPS amendments. We are concerned that MECP's comparison of "direct compliance costs" will prove insufficient to account for additional cost savings awarded under the Federal OBPS as a result of increased program flexibility over the EPS.

Additional concerns are raised regarding the expected environmental outcomes (i.e., measurable greenhouse gas reductions) of the proposed EPS amendments. MECP has not provided any indication of the estimated reductions that would result from proposed EPS amendments compared to the results under the Federal OBPS. With lower imposed costs, it would be expected that the EPS would result in less reductions (compared to the Federal OBPS), raising environmental integrity concerns. IETA requests further information regarding estimated environmental outcome impacts of the proposed EPS amendments.

Return of Proceeds Program:

Ontario has signaled that EPS proceeds will be used to support industrial GHG emissions reductions, but no final plans have been released. IETA strongly supports the use of proceeds to support industrial decarbonization and recommends that Ontario take a similar approach to proceeds recycling used by Alberta under the Technology Innovation and Emissions Reduction (TIER) program. To date, TIER's large-emitter carbon market has generated over $600 million in program revenue from Alberta and has mobilized investments totaling over $4.5 billion in value with a total estimated climate impact of nearly 40 million tonnes of GHG emissions reduced.[4]

Voluntary Carbon Market Considerations:

[4] Source: https://eralberta.ca/impact/

IETA encourages the Ministry to enable voluntary carbon market (**VCM**) opportunities across the province. While not directly supporting regulated emitters, high-integrity voluntary offsets generation through reduction/removal projects can channel much-needed revenue to support corporate net zero transitions, while driving investment into a range of Ontario sectors and communities.

EPS Policy Review

The EPS regulation does not currently include requirements for scheduled future EPS program reviews. IETA recommends that MECP amend the EPS regulation to require policy reviews every 2-3- years throughout the 2023-2030 period. Regular reviews will better enable the provincial program to continue supporting Ontario reduction targets while ensuring adequate measures can be taken – including, but not limited to, preserving the competitiveness of Ontario regulated facilities. When conducting each review, MECP should engage industry and external stakeholders to provide practical expertise to help inform policy updates.

CONCLUSION

Once again, we thank MECP for its efforts to engage IETA and other stakeholders on the critical post-2022 EPS regulatory amendments. If you have questions or require further information on IETA's insights and recommendations, please contact Joseph Hoekstra at hoekstra@ieta.org.

Annex 1: Refresher - Why Offsets Matter to Ontario

Offsets Provide Economic Benefits & Preserve Competitiveness: Offsets provide an alternative for regulated emitters to substitute real GHG emission reductions made outside of sectors under the pollution pricing program, presumably at lower cost, for emission reductions in their own facilities. Trading and access to offset reductions provide necessary compliance and policy flexibility. These measures can help drive low-carbon innovative solutions and investments, capitalize on new revenue streams, manage competitiveness concerns, and pursue clean investments on a logical timescale. Flexibility also gives regulated industries the ability to gradually transition and meet compliance obligations while adopting new low-carbon strategies, technologies and processes that work best for their operations, human resource capacity, supply chains, and consumers.

Offsets Spur Job Creation & Growth: Offsets offer financial benefits to rural Northern and First Nation communities, small business owners, and local entrepreneurs by creating new revenue streams and jobs. These new revenue streams also create economic diversification in communities that may rely heavily on only one or two industrial activities. Potential projects are available for a wide array of sectors, including forestry, farming, and waste management and will therefore reach communities across Ontario.

Offsets Drive Innovation: By their very definition, offsets act as an innovative and direct financing tool, driving the implementation of new technologies and practices that would not have happened under business as usual. This tool provides a new way for technologies and resource management practices to progress from the lab to the field, providing abundant opportunities for partnerships between the research community and business. Years of industry experience across multiple programs and regions have demonstrated that properly designed offset systems drive clean innovation and entrepreneurialism by providing a clear price signal upon which to invest.

Offsets Provide Environmental & Community Benefits Beyond Climate: Underwritten by a pollution pricing system, offsets can provide various non-climate environmental improvements for free. For example, offsets generated through fertilizer management can limit nutrient run-off; offsets generated through wetlands restoration can create waterfowl habitat and flood protection; offsets created through improved forest management, reforestation, and avoided degradation sustain robust ecosystems, potentially far into the future. In such ways, offsets can help achieve important non-climate environmental objectives without additional expenditure.

Growing Demand Sources: Incorporating offsets into the EPS enables Ontario to capitalize on growing demand sources both within and outside of the province. Currently, projected long term credit demand growth is driven by compliance linkage opportunities both domestically and internationally, growth in the Voluntary Carbon Market (VCM), and compliance with forthcoming federal measures.

With the adoption of the Paris Agreement Article 6 Rulebook at COP26, Canadian provinces (such as Alberta with its longstanding offset program) are presented with significant opportunities to advance and benefit from international developments as Article 6 becomes operationalized. Lacking functioning offset infrastructure, Ontario will miss a critical opportunity to establish itself as a global leader and trusted partner in clean technology development, finance, and exports.

Additionally, demand for high-integrity credits across the world's hyper-evolving Voluntary Carbon Market has soared in recent years.[5] Without an operational offset system, Ontario cannot capitalize on today's rapid and forecasted VCM growth, which could enable and actively promote voluntary demand for – and use of – mature, robust, and high-quality offset credits, channeling massive investment into the province.

Last, several forthcoming federal climate policy measures represent major opportunities for offsets as potential compliance units; meaning these measures could open-up new demand sources for new Ontario-sourced credit supply, should the province incorporate offsets into the ETS. Most prominently, the proposed Federal Oil and Gas Emissions Cap raises the possibility of enabling robust high-quality offsets for compliance.

Annex 2: Practical Steps for EPS Recognizing Offsets for Post-2022 Compliance

Ontario should rely heavily on the lessons, systems, standards and infrastructure from existing carbon pricing and market programs. Specifically, when developing an offset strategy Ontario should lean on work already done by the Federal OBPS offset system. Building on and ensuring complementarity with the Federal OBPS offset system will enhance efficiencies, minimize program

[5] "The VCM grew in value towards $2 Billion in 2021. … [Q]uadrupling in market value from 2020." Source: https://www.ecosystemmarketplace.com/articles/the-art-of-integrity-state-of-the-voluntary-carbon-markets-q3-2022/

development and implementation costs, enable near or longer-term cross-border harmonization opportunities, and ensure broad program buy-in.

We see two distinct pathways for Ontario to practically include offsets for post-2022 EPS compliance. Due to time constraints, the province will have limited design flexibility and will need to lean heavily on existing infrastructure under the Federal OBPS offset system:

- Option 1 would see the EPS recognizing all federal units
- Option 2 would see Ontario using existing federal frameworks to develop EPS-specific offset units to be recognized federally

Option 1:

Option 1 presents the quickest and most efficient pathway for Ontario to include offsets in the EPS. Under this option, Ontario would update the EPS to include current systems, standards, and infrastructure from the existing Federal OBPS offset system. Amendments would be made to allow covered entities to procure and surrender federal offset credits for compliance under the EPS.

Using federal offsets and protocols would allow Ontario to avoid the long and tedious offset framework and protocol development process. Given the short time constraint, it would be challenging for Ontario to design and implement an entirely new offset framework.

Aligning the EPS GHG program rules, tools, standards, carbon accounting, and quantification methodologies with the Federal OBPS offset system allows for robust inter-provincial cooperation.

In addition to "piggybacking" off the Federal OBPS offsets system, we strongly recommend that the EPS be amended to allow for the use of compliance offsets already issued by other Canadian governments across existing carbon programs. OBPS offsets and other existing Canadian offset units represent real and verifiable GHG reductions and removals, which would provide "out of the gate" supply for regulated emitters in Ontario.

Option 2:

If Ontario declines compliance offsets already issued by the Canadian federal and provincial governments across existing carbon programs (in favour of Ontario-specific offset protocols), they should not aim to “reinvent the wheel”. Instead, **Ontario should adapt current systems, standards, and infrastructure from the existing Federal OBPS offset system to meet their specific needs**. These systems are tried and tested and should be leveraged as much as possible. **Under this option, Ontario-administered protocols and issuances would be developed by the provincial government while leaning on all/some of the existing infrastructure and/or frameworks from the Federal OBPS offset system, ensuring all Federal Recognized Units requirements are met.** Ontario could also leverage some of the protocols developed in its previous offset programs, such as Anaerobic Digestion, Landfill Methane Management and Livestock Manure Management. Additionally, the ability for external parties to propose new protocols by submitting a draft scoping document would be an effective means of encouraging timely protocol development and stakeholder engagement.