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## Comments to the Government of Ontario on the Development of a Cap-and-Trade System for Reducing Greenhouse Gas Emissions in Ontario

*Submitted by the David Suzuki Foundation,<sup>1</sup> the Pembina Institute<sup>2</sup> and WWF-Canada<sup>3</sup>  
March 2009*

Through its Go Green Action Plan, proposed Green Energy Act and membership in the Western Climate Initiative, the Government of Ontario has demonstrated its interest in implementing serious measures to reduce greenhouse gas (GHG) emissions. In their 2008 Memorandum of Understanding (MoU), the governments of Ontario and Québec recognized that “strong, immediate and sustained action is an absolute requirement to minimize the risks posed by climate change” and committed to develop a joint cap-and-trade system to take effect as early as 2010.

In this context we are pleased to provide the following comments in response to the Government of Ontario’s December 2008 Discussion Paper *A Greenhouse Gas Cap-and-Trade System for Ontario*.

### ***Key Principles and Timing***

#### **Ontario’s Key Principles for Cap-and-Trade**

The Discussion Paper presents a series of “key principles” for cap-and-trade, with which we generally agree:

- Absolute reductions in emissions of greenhouse gases must occur;
- Trading rules must be simple, consistent and transparent;
- Program must be administratively efficient;
- Equitable treatment must be assured among the capped sectors;
- Credit for early action must be available to industry leaders;
- Emissions measurement, monitoring and reporting must be accurate;
- Development and deployment of clean technologies must be integrated into the trading program; and
- Trading opportunities must be facilitated with comparable regional and national trading systems.

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We believe that the best way to achieve these goals is to implement a system that

- has the broadest practical coverage (including all emissions from fossil fuel use)
- features 100% auctioning of emissions allowances
- does not include offsets, or limits them to a small proportion of emission reductions
- uses auction revenues to support priority emission reduction activities that will not be adequately encouraged by the cap-and-trade system, and to counter any undesirable impacts resulting from its implementation.

Broad coverage will maximize **emission reductions** and **equity** among different emission sources; and because the number of regulated entities need not be large, it will remain **administratively efficient**. 100% auctioning will maximize simplicity and **administrative efficiency** (including, importantly, the ability to implement the system quickly), while automatically **rewarding early action**. Offsets are complex and costly to administer, present major measurement challenges and can undermine emission reductions; avoiding or tightly limiting them will improve **administrative efficiency, measurement accuracy and emission reductions** while also preventing a dilution of the price signal needed to drive the **deployment of clean technologies** in the covered sectors. Auction revenues can be used to address remaining **equity** issues and further support the **development and deployment of clean technologies**.

Broad coverage, auctioning and limits on offsets feature prominently in leading cap-and-trade systems currently under development in North America and elsewhere; an Ontario system with these characteristics would therefore be well positioned for future links to such systems.

## The Case for Starting in 2010

We agree with Minister of the Environment John Gerretson's statement that "today [is] the best possible time to develop a cap-and-trade system."<sup>4</sup> The Government of Ontario has clearly signalled, in the Discussion Paper and the earlier MoU with Québec, its desire to implement a cap-and-trade system with a cap coming into effect on January 1, 2010. We believe that there are several strong reasons to maintain this timeline:

- Putting a significant price on GHG emissions broadly in the economy is the central policy needed to cut GHG emissions and deploy clean technology. Ontario needs to take this step as quickly as possible to attain a leadership position on these issues. In particular, the UN climate conference in Copenhagen, in December 2009, will be a key moment of public and international attention when the Government of Ontario will want to be able to demonstrate that it is taking serious action to cut emissions.
- Early action can help with economic recovery. Although the cap-and-trade system needs to put a significant price on emissions at the outset, at least \$30/tonne CO<sub>2</sub>e,<sup>5</sup> economic modelling suggests that a price at this level is likely to be beneficial to Ontario's GDP by spurring innovation, efficiency gains and new sources of sustainable growth. If there is a serious risk of harm to a specific sector, it can be addressed through the use of auction revenues.

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<sup>4</sup> Ontario Ministry of the Environment, *What is Cap and Trade?*, <http://www.ene.gov.on.ca/en/air/climatechange/capAndTrade.php> (accessed February 18, 2009).

<sup>5</sup> Carbon dioxide equivalent.

- In fact, the current uncertainty about future federal and provincial government policy on GHG emissions creates risk for businesses and delays investments in clean technology. Moving quickly to implement cap-and-trade will significantly help to reduce that uncertainty, give Ontario's businesses a head start in capturing the opportunities created by a price on emissions and emissions trading, and emerge from the recession as leaders.
- It is clear that cap-and-trade systems are going to be implemented throughout Canada and the U.S. within the next few years. Ontario's ability to influence decisions on those systems — i.e., as a policy-maker, not a policy-taker — depends on the province gaining credibility, practical experience and a clear understanding of its interests by moving as quickly as possible towards implementation of cap-and-trade.
- A cap-and-trade system with auctioning, starting in 2010, would provide a valuable new source of revenue at a time when reduced government revenues resulting from the economic slowdown could seriously challenge Ontario's ability to make needed investments — notably, investments needed to meet the province's GHG targets.

## ***Design Issues***

The Discussion Paper lays out ten design issues for Ontario's cap-and-trade system. Sections 1–10 below contain our comments on each of these.

### **1. Linking with the Western Climate Initiative**

The architecture of the cap-and-trade system that we are proposing Ontario implement in 2010 would be fully compatible with that of the Western Climate Initiative (WCI), thus facilitating future linking if appropriate. **The WCI recommendations provide the flexibility for Ontario to demonstrate best practice in the form of broad-as-practical coverage, 100% auctioning and avoidance of offsets (or tight limits on their use).** By implementing a simple and highly effective system with these characteristics in 2010, Ontario would set the standard by which other systems proposed in North America — including those of other WCI jurisdictions — would be measured. This would place Ontario in a strong position to advocate for greater stringency and environmental integrity in those systems.

However, **Ontario should only take the decision to link its system with the WCI or other systems once it has satisfied itself that those systems do indeed have comparable stringency and environmental integrity to Ontario's.** When a weak system is linked to a strong one, the weaknesses of the former are imported into the latter via trading. Although linkage generally has the advantage of bringing economic efficiencies, they must not come at the cost of environmental performance.

### **2. Emissions Caps**

We regard the factors proposed in the Discussion Paper for cap-setting as useful. **Most importantly, the sectors covered by the cap-and-trade system must make a fair contribution to meeting Ontario's province-wide emissions targets.** The initial cap level should be designed to put a price of at least \$30 on each tonne (CO<sub>2</sub>e) of emissions — a level necessary to begin stimulating significant investment in solutions. Determination of the initial cap level will therefore need to be informed by the best possible information about (i) recent measured emissions from covered sources, (ii) expected subsequent changes in emissions based on economic trends, and (iii) emission reduction cost curves for those sources. Subsequent cap

levels should then represent linear reductions to meet the province's percentage reduction targets. In other words, sectors covered by the system would reach 6% below their collective 1990 level by 2014 and 15% below the 1990 level by 2020. This is consistent with Ontario's commitment to use 1990 as a base year.

If caps are set at a less stringent level, then a disproportionate responsibility for Ontario's emission reductions will be transferred to sectors not covered by the system. This could only be acceptable if the government is able to demonstrate clearly that policies for those sectors will allow the province-wide targets to be met and that the associated costs to taxpayers are reasonable. Demonstrating this will be very challenging if the cap-and-trade system is as broad as practical, as we recommend in Section 3 below. Indeed, caps will need to be set at a more stringent level than recommended above if analysis indicates that sufficient reductions cannot be obtained from non-covered sources.

The EU's Emissions Trading Scheme (EU ETS) has highlighted the risks of setting the initial cap too loosely. The collapse in the emissions price in Phase I of the EU ETS (2005–07) represented a failure to meaningfully reduce emissions, a missed opportunity to stimulate needed investments in solutions and exposed the system to widespread criticism. The main cause appears to have been a lack of adequate emissions data prior to start-up. This underlines the need for Ontario to move immediately to obtain recent, accurate, transparent and independently verified data for sources to be covered by its system. To minimize the risk of failure, **the data used for cap-setting should be as close as possible, in both quality and comparability, to the data used for determining compliance** (see the recommendations in Section 9 below).

We support inclusion of the six Kyoto GHGs from the outset. Cap-and-trade legislation and/or regulations should provide for additional GHGs to be added later if a future UN global climate agreements includes additional gases.

### 3. Scope and Point of Regulation

There is a strong expert consensus that putting a price on GHG emissions broadly in the economy is the central policy needed to cut GHG emissions. For example, the National Round Table on the Environment and the Economy (NRTEE) recently concluded: "Strong, consistent and economy-wide emission pricing is required as soon as possible if cost-effective [GHG] emission reductions are to be sustained to mid-century."<sup>6</sup> The NRTEE added: "Applying the emission price broadly ensures an equitable distribution of cost while seeking reductions from all segments of the economy."<sup>7</sup>

This makes it clear that **to maximize emission reductions and equity among different emission sources, Ontario should strive for the broadest practical coverage for its cap-and-trade system**. From the perspective of the "polluter pays" principle, exempting any emissions from an emissions price is an unfair subsidy, because every tonne emitted, from whatever source, creates costs for the whole of society. (At the same time, fairness also demands that low-income individuals be fully protected from the consequences of an emissions price.) British Columbia

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<sup>6</sup> National Round Table on the Environment and the Economy, *Getting to 2050: Canada's Transition to a Low-emission Future* (Ottawa, ON: NRTEE, 2007), 11. Also available online at <http://www.nrtee-trnee.ca/eng/publications/getting-to-2050/Getting-to-2050-low-res-eng.pdf>.

<sup>7</sup> Ibid., 20.

has already demonstrated, through its carbon tax, the feasibility of implementing economy-wide emissions pricing, covering industry, transportation and buildings, in just a few months.

We therefore disagree with the Discussion Paper's proposal that Ontario's system start with only large industrial sources and high thresholds (100kt CO<sub>2</sub>e). Because of the time needed to replace capital stock, a broad and strong price signal is needed now if medium-term GHG targets — including those adopted by Ontario — are to be met. **The urgency of the issue and the clear feasibility of broad coverage mean that starting with a narrow system cannot be justified.**

Instead, **the cap should cover all emissions from combustion (or other use) of traded fuels from the start.** If the regulated entities are fuel wholesalers (who would be required to hold allowances in respect of emissions resulting from combustion of the fuel that they sell), then their number will not be large, and the system will remain administratively efficient. Cap coverage should also be able to include emissions from fossil fuel production/distribution (refineries, pipelines) and industrial process emissions, since industry already has many years of experience with quantifying these emissions.

**To ensure adequate coverage, the thresholds for regulated entities should be set so as capture at least 90% of emissions from the types of sources<sup>8</sup> covered by the cap. As a first step, thresholds should initially be set at 25kt CO<sub>2</sub>e, the level agreed by the WCI, and be subsequently lowered where practical.** In addition to expanding coverage, this will allow smaller sources to gain experience in advance of potential linkage with the WCI or other systems.

With 100% auctioning of allowances, there will be no need to determine allowance allocations for each sector under the overall cap.

**Broad coverage in a cap-and-trade system does not remove the need for targeted regulations and investments** in sectors such as transportation or buildings, even when those sectors are covered by the cap-and-trade system. Such measures are essential to overcome market barriers or failures and to spur sufficient immediate action while the price on emissions remains relatively low.

#### **4. Electricity Sector**

We support the Discussion Paper's proposal to cover all electricity generated in the province as well as all imported electricity consumed in the province, regulated at the point of first sale. This is in line with the approach agreed by the WCI, and is necessary to ensure that Ontario takes full responsibility for electricity-related emissions.

As noted above, we believe that the threshold for regulated entities should begin at 25kt CO<sub>2</sub>e and 100% of allowances should be auctioned. Auctioning of 100% of allowances in the electricity sector avoids the need to align free allocations with the timeline for coal phase-out.

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<sup>8</sup> By "types of sources," we mean, e.g., combustion sources or fugitive sources in a given sector.

## 5. Distribution of Allowances

We believe **there are overwhelming reasons why 100% of allowances in Ontario's cap-and-trade system should be auctioned from the start:**

- *100% auctioning dramatically reduces the number of political decisions.* Free allocation of allowances necessitates an exceptionally complicated series of decisions about how the free allowances will be distributed among sectors, years, types of emissions, existing versus new facilities, and early actors. Each of these decisions is inherently political, because each depends on a subjective judgment of what is fair. Free allocation essentially invites a fight to obtain the free allowances, with virtually every sector likely to come forward with reasons why it is especially deserving. This can be expected to be very challenging and time-consuming for both politicians and officials to manage. 100% auctioning eliminates all of these decisions, and allows for a simple regulatory framework that can be implemented in a matter of months.
- *More auctioning does not imply more stringency.* In a cap-and-trade system, economic decisions are essentially determined by the market price of allowances, which is independent of the method of allocation. The key measure of stringency, then, is the total number of allowances issued, i.e., the level of the cap. It is the cap which will determine the price — not how many allowances are given away free of charge. This means that creating a transition from a system that is relatively non-stringent at the start to one that is more stringent later is entirely possible while auctioning 100% of allowances right from the beginning. The fact that the method of allocation doesn't affect stringency also means that the extent of auctioning is not a key consideration for linking Ontario's system to another, since comparable stringency is the key requirement for linking.
- *Free allocations are subsidies, and many sectors won't need them.* By implementing a cap-and-trade system, society is deciding that the use of the atmosphere is a limited resource with a financial value. If the government gives away portions of that resource in the form of allowances, it is providing a financial benefit to the recipients — a benefit that others who will nonetheless be affected by the system, such as individuals or non-emitters, do not receive. In other words, free allocations are subsidies. An understanding of this point is now prominent in cap-and-trade discussions in the EU and the U.S., where auctioning of allowances is increasingly seen as the “default,” with deviations from it requiring justification. Notably, President Obama has committed to 100% auctioning. The EU's system provides one well documented instance where free allocation was demonstrated to be an egregious subsidy, when electricity generators reaped windfall profits by passing on the full value of their allowances to consumers, despite having only paid for a small fraction of them.
- *It's better to provide necessary subsidies in dollars, not allowances.* There are two categories of deserving recipients of subsidies when a cap-and-trade system is implemented: low-income individuals, and industry sectors whose activities and emissions would be significantly shifted outside the jurisdiction but not reduced (“carbon leakage”). For deserving individuals, it obviously makes more sense for the government to provide the necessary protection in the form of dollars, not allowances. There are two important reasons why it's better to do the same for deserving industry sectors. First, government has much more experience, control and flexibility in providing dollars via its

spending power and the tax system than it does in providing allowances via environmental regulations. For example, financial subsidies can be used to reduce carbon leakage, provided that they have an adequate degree of proportionality to output. In contrast, environmental regulations can be difficult to change when needed, and can become extremely complex when allowances are provided free of charge (see above). Second, the provision of free allowances tends to fuel a sense of long-term entitlement to them. This distracts attention from the central question raised by free allocations, which is whether those subsidies are needed at all, and if so for how long.

- *100% auctioning automatically rewards early action.* It is much more administratively efficient to address “credit for early action” automatically, through the basic design of the cap-and-trade system, than through a special process requiring the government to assess the merits of actions taken by different sectors or firms. 100% auctioning automatically rewards early action, because those who have already reduced their emissions have fewer allowances to buy.
- *Auctioning allows much greater public investments in climate solutions.* Meeting Ontario’s GHG targets is realistically going to require an order-of-magnitude increase in public spending targeted at climate solutions in the next few years. This need will present itself during a period when governments will be trying to eliminate and pay back the deficits resulting from the current economic crisis. It is therefore questionable whether it will be possible to allocate the necessary funds without a new source of revenue. President Obama has been explicit that his commitment to invest \$150 billion over ten years in “clean energy” will be entirely funded from auctioning allowances. And polls show that Canadians like the idea of using emissions pricing revenues to pay for green solutions.<sup>9</sup>
- *100% auctioning allows the establishment of an effective emissions price floor.* To avoid the risk of setting the initial cap too loosely (e.g., because of inadequate data, or uncertainty about trends in emissions since the most recent year in which they were measured), it is desirable for the government to be able to set a floor price for allowances. Otherwise, the price could fall too low to provide an effective incentive for investments in clean technology. The most straightforward way to set a price floor is through 100% auctioning, where the government simply sets a “reserve” price for allowances.

We believe that **auction revenues should be used (i) to help ensure that Ontario meets or exceeds its province-wide GHG targets and (ii) to address any remaining equity issues;** these will both be important factors in ensuring the credibility of the cap-and-trade system.

Accordingly, we believe that revenues should be used for the following purposes:

- Funding a massive scale-up in public investments in GHG-reducing activities, technologies and infrastructure for which the cap-and-trade system alone is not expected to provide a sufficient incentive — at least until the emissions price reaches the necessary

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<sup>9</sup> For example, a May 2008 poll asked Canadians about their preferred use of carbon tax revenues if the federal government were to implement such a tax, and found that 47% of respondents wanted revenues spent on “renewable energy like wind and solar power,” compared to only 11% who wanted the money used for “reduced income taxes.” See <http://pubs.pembina.org/reports/C-TaxPoll-Background.pdf>.

level. These include, notably, renewable electricity, energy efficiency in buildings, public transit, and activities to reduce GHG emissions in agriculture and forestry.

- Fully compensating low-income individuals from any increased costs resulting from the cap-and-trade system.
- Providing subsidies to any industry sectors that are *demonstrably* likely to suffer significant carbon leakage.<sup>10</sup> The probability of carbon leakage depends on a sector's trade exposure, compliance costs as share of profits, return on investment net of compliance costs, and global mobility. To be eligible for such subsidies, sectors would have to be convincingly shown to be indeed at significant risk of leakage. To remove such assessments from political influence, they should be conducted by an independent expert panel.

Once the above needs have been fully met, remaining revenues can be used to reduce general tax rates.

## 6. Offsets

The principal rationale for including offsets in a cap-and-trade system is to limit the cost of compliance for covered emission sources. An offset system does not result in extra emission reductions; instead, it replaces emission reductions from covered sources by reductions from non-covered sources.

Our organizations encourage voluntary purchases of offsets by individuals or organizations to enable them to further address their environmental footprint once they have taken all reasonable steps to minimize their own emissions. However, for purposes of compliance with a cap-and-trade system, offsets present several formidable disadvantages:

- It is very difficult to be confident that offsets represent genuine, “additional” emission reductions. If offsets are granted for “non-additional” emission reductions that would have happened anyway (i.e., that would have happened even in the absence of the offset system), then Ontario's total emissions will be higher with the offset system than without it, as emitters will use “non-additional” offsets to replace real reductions they would have otherwise been required to make by the cap-and-trade system. This will weaken the environmental performance of the system.
- To try to prevent this occurring, it is necessary to adopt elaborate rules and procedures to enforce the rules. This results in a high level of administrative complexity and cost. The world's largest GHG offset system to date, the Kyoto Protocol's Clean Development Mechanism (CDM), incorporates a complex set of rules to ensure that only additional emission reductions receive credits. Despite this, some researchers have concluded that “only a fraction” of CDM credits represent additional emission reductions.<sup>11</sup>
- With a broad-as-practical cap-and-trade system (see Section 3), there will be limited scope for additional offsets. Even if the system does not cover sectors like transportation,

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<sup>10</sup> To successfully address carbon leakage, subsidies need to have a degree of proportionality to output.

<sup>11</sup> David Victor, *Global Warming Policy After Kyoto: Rethinking Engagement with Developing Countries* (Stanford, CA: Stanford University Program on Energy and Sustainable Development, 2009), 13. Also available online at [http://iis-db.stanford.edu/pubs/22383/CAD\\_Working\\_Paper\\_82.pdf](http://iis-db.stanford.edu/pubs/22383/CAD_Working_Paper_82.pdf).

buildings and waste, there will be limited scope for additional offsets because governments are implementing targeted GHG reduction policies in those sectors, and it will be very difficult to disentangle additional reductions from reductions caused by government policies.

- In sectors like agriculture and forestry, there is currently greater scope for additional offsets. However, a more appropriate alternative to offsets is the implementation of strong GHG reduction policies targeting those sectors (which could include purchase of offsets by government, separate from the cap-and-trade system). Also, many potential offsets in agriculture and forestry may only be temporary; these reductions rely on storing carbon in biological systems, from where it can be easily released (for example, by logging, forest fire, or changes in agricultural practices).
- If a large volume of offsets can be created cheaply, then they risk reducing the market price of allowances in the cap-and-trade system to the point where there is no longer an adequate incentive for covered firms to invest in clean technologies for their own operations.

Given these major problems, we believe that **Ontario's cap-and-trade system should not include offsets (domestic or international)**. We do, however, recognize the case for providing covered firms with some insurance against excessive compliance costs caused by unforeseeably high allowance prices. The government could do this by adopting a provision to sell additional allowances if the allowance price reached a "ceiling" level. To maintain the system's overall environmental performance, these additional allowances would be withdrawn from the subsequent compliance period. Because this provision would delay emission reductions, it should only be triggered in exceptional circumstances. The ceiling level should therefore be set much higher than the expected allowance price. This means that the ceiling should be no lower than \$50/tonne CO<sub>2</sub>e initially, and no lower than \$200/tonne by 2020.

**If the government nonetheless chooses to include offsets in its cap-and-trade system, we believe that to limit the problems described above, offsets should be limited to a small proportion of emission reductions. If the system includes offsets, there should be no ceiling price mechanism such as the one described above.**

The Discussion Paper's statement that "the offset projects would have to demonstrate that they offer environmental benefits that would not have occurred in the absence of the project" is a wholly inadequate definition of additional emissions reductions. If the project would have happened anyway, in the absence of the offset system, then "the absence of the project" will be an inflated (higher-than-business-as-usual) baseline for quantifying reductions. Instead "absence of the project" should be replaced in this statement by "absence of the offset system." **This additionality requirement is fundamental to offset credibility and protecting the environmental performance of the cap-and-trade system.** Additionality must be assessed by government officials (not just by project proponents), with provision for meaningful public input, using a tool at least as comprehensive as the CDM's "Tool for the demonstration and assessment of additionality." In addition, the assessment process will need to be more rigorous than has been customary in the CDM.

**Given the current problems with the additionality of CDM credits, they should not be accepted in Ontario's system.**

In addition, if the system includes offsets, to be credible they must be:

- granted only for reductions occurring after Ontario adopts final cap-and-trade regulations (this requirement is necessary to ensure additionality);
- re-evaluated every seven to eight years to determine the quantity of emission reductions that can still be credibly credited;
- temporary, if based on biological carbon storage;
- rigorously quantified through independent third-party validation and verification in accordance with recognized standards;
- claimed by a single individual/organization and not double-counted;
- transparent with full information on project details and quantification accessible to the public;
- evaluated based on other environmental and social impacts.

## 7. Credit for Early Action

Based on the equity principle of “polluter pays,” it is desirable that firms covered by the cap be rewarded for early action they took to reduce emissions before the cap takes effect. However, this should be tempered by two considerations. First, if “early action” was part of “business as usual,” required for other reasons or did not involve any significant financial sacrifice, then rewarding it loses much of its importance. Second, administrative efficiency requires that the process for rewarding early action be simple, and ideally automatic; it should therefore avoid firm-by-firm assessments.

**If 100% of allowances are auctioned, as we recommend, then early action will be automatically rewarded** because those who have already reduced their emissions will have fewer allowances to buy.

Given Canada’s past and ongoing lack of clarity as to governments’ intentions with regard to regulation of GHG emissions, we do not believe it is likely that more than a handful of Ontario firms have to date made significant financial sacrifices to reduce emissions. We therefore believe that **the elaborate and administratively costly firm-by-firm determination of early action suggested in the Discussion Paper cannot be justified**. Ontario’s cap-and-trade system should be focused on reducing emissions going forward, not on determining precisely which firms reduced emissions in the past.

An additional specific point is that firms’ past voluntary purchases of offsets should not be recognized as early action in Ontario’s cap-and-trade system.

## 8. Banking and Borrowing

**We agree with the Discussion Paper’s proposal that banking of allowances be allowed and borrowing be prohibited**, and with the reasons that the paper provides in each case.

However, we recommend that the government retain the option of cancelling banked allowances at the end of a compliance period if they amount to an excessive proportion of the total allowances allocated for that period — which would indicate that the cap had been set too loosely. The risk of this will be greatest for the first compliance period, when the data used for

cap-setting may be of lower quality. Transparent rules will need to be established to ensure that the government can only exercise this option in a predictable manner.

## 9. Compliance and Reporting

**We agree with the Discussion Paper’s proposed 2+3+3+3-year compliance periods**, which align with the WCI and provide an appropriate balance between flexibility for covered firms (suggesting longer periods) and certainty of achieving emission reductions by specific dates (suggesting shorter periods). However, compliance periods may need to be adjusted if they do not align with international compliance periods established by the forthcoming UN global climate agreement for the post-2012 period.

To support our recommendation (Section 3 above) that the threshold for regulated entities should begin at 25kt CO<sub>2</sub>e, **reporting at this threshold will need to be required for a recent year prior to startup of the cap-and-trade system (e.g., 2008 emissions)**. This will also help lessen the abruptness of the shift to reporting at a threshold of 10kt CO<sub>2</sub>e for 2010 emissions, as agreed for the WCI.

Regardless of the initial scope of the system, **we urge that mandatory reporting to support a broad-as-practical system be introduced immediately to ensure Ontario is well positioned to maximize the scope of its system in later compliance periods**.

Given that a cap-and-trade system creates a financial market for emissions, emissions accounting for the purposes of such a system must be of equal rigour to financial accounting. **It is therefore essential that emissions data used for determining compliance be subject to independent third-party verification in accordance with recognized standards**. As noted in Section 3, the data used for cap-setting needs to be as close as possible, in both quality and comparability, to the data used for determining compliance. Thus, the same standard of verification should be applied (to the fullest extent possible) to the data used to set the initial cap.

**Emissions data and the serial numbers of allowances or credits submitted by each firm for compliance should be fully accessible to the public via the internet**. This is important both for the credibility of the cap-and-trade system and in order to respect the public’s environmental right to know.

## 10. Economic and Competitiveness Analysis

We welcome the government’s use of economic modelling to inform the design of Ontario’s cap-and-trade system. Economic modelling will be especially important in ensuring that the initial cap is tight enough to put a price on emissions high enough to begin stimulating significant investment in solutions. As noted in Section 2, we believe this should be at least \$30/tonne CO<sub>2</sub>e.

Several studies have shown that the risks of significant harm to competitiveness and associated “carbon leakage” as a result of cap-and-trade systems are often overstated and, where they are real, limited to only a few sectors.<sup>12,13</sup> As noted in Section 5, the government should only

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<sup>12</sup> See Clare Demerse and Matthew Bramley, *Choosing Greenhouse Gas Emission Reduction Policies in Canada* (Drayton Valley, AB: The Pembina Foundation, 2008), 41–42. Also available online at <http://climate.pembina.org/pub/1720>.

consider providing output-related subsidies to reduce carbon leakage in a specific sector after the probability of leakage has been determined through an assessment of that sector's trade exposure, compliance costs as share of profits, return on investment net of compliance costs, and global mobility. To remove carbon leakage assessments from political influence, they should be conducted by an independent expert panel. To ensure that discussions about competitiveness are well informed, the government should initiate this independent assessment process now.

We also note that under both Phase III of the EU ETS and Australia's forthcoming cap-and-trade system, objective and transparent formulas will be used to identify the sectors that will be given special protection from carbon leakage. However, we recommend that Ontario adopt an Ontario-specific assessment to inform these assessments.

## **Conclusion**

Ontario has a significant opportunity and responsibility to act now to ensure that GHG emissions within its boundaries are controlled. Given the continued absence of serious federal action, Ontario's window of opportunity for meeting its GHG targets will soon close if the provincial government does not act urgently to regulate and put a price on emissions. By acting decisively now to implement a strong cap-and-trade system by January 1, 2010, Ontario can get on track to meet its targets and make a significant contribution to the global effort to avoid dangerous and irreversible climate change. It can also ensure that Ontario's businesses get an early start in preparing for the carbon-constrained economic environment of the 21st century, and are in a energy-efficient and competitive position going forward.

By moving decisively now to implement a robust and effective cap-and-trade system, Ontario can also influence the emerging climate policy framework in Canada and even internationally. As the first jurisdiction in North America to implement a broad-based cap-and-trade system, Ontario would attract attention and recognition as a leader. It would be establishing precedents that could be influential within the Western Climate Initiative and within Canada, and it could even have an impact on U.S. federal developments.

But Ontario's position as a leader and its chance to influence positively other emerging cap-and-trade systems will depend crucially on its success in implementing a credible, robust system that covers the majority of Ontario's emissions and puts a price on emissions that is predictably high enough to drive significant emissions reductions. If, on the other hand, Ontario's system fails to cover key sectors, issues free allowances, includes loopholes, or is subject to the same problems of over-allocation and price collapse that plagued the first phase of the EU's system, it risks not only failing to meet Ontario's GHG targets, but also being seen as yet another example of mistakes to be avoided. If instead we can implement a well-designed and effective cap-and-trade system, Ontario can be a beacon to the rest of the country, the continent and the world, as a success to be emulated.

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<sup>13</sup> Chris Bataille, Benjamin Dachis and Nic Rivers, *Pricing Greenhouse Gas Emissions: The Impact on Canada's Competitiveness* (Toronto, ON: C.D. Howe Institute, 2009). Also available online at [http://www.cdhowe.org/pdf/commentary\\_280.pdf](http://www.cdhowe.org/pdf/commentary_280.pdf).