IETA COMMENTS ON PROPOSED REGULATORY FRAMEWORK

Proposed Output-Based Pricing System (OBPS) Regulatory Framework

The International Emissions Trading Association (IETA) appreciates this opportunity to share input on the Government of Canada’s proposed Output-Based Pricing System (OBPS) Regulatory Framework (the Proposal). The Proposal builds on the 2017 Federal Carbon Pricing Backstop Technical Paper and provides additional information on the proposed design of the OBPS, a key element of the January 2018 Federal Greenhouse Gas Pollution Pricing Act (GGPPA). Across provinces and territories where GGPPA applies, the OBPS is being developed for large industrial facilities that emit 50,000 tonnes or more of greenhouse gas (GHG) emissions per year. We applaud the Federal Government’s commitment to price carbon in a responsible, coordinated, flexible manner across all Canadian jurisdictions.

ABOUT IETA

For two decades, IETA has been the premier international business voice on carbon pricing and climate finance, including the design and implementation of flexible, compliance emissions trading and offset systems. Our multi-sector non-profit organization represents over 150 Canadian and international companies, including many across emissions-intensive, trade-exposed (EITE) industrial sectors. IETA’s market and technical expertise is regularly called-upon to inform policies that deliver incremental GHG reductions, minimize carbon leakage, address competitiveness concerns, and balance economic efficiencies with social equity and co-benefits.

We believe that robust, least-cost approaches to carbon pricing should form the backbone of Canada’s climate action to 2030 and beyond. These powerful market-based approaches must be underpinned by environmental integrity and allow for flexible compliance, linking and cross-program/border unit fungibility. Provided its final framework follows these guiding principles and objectives, we believe that Canada is well-positioned to be recognized globally for its OBPS policy innovation and market leadership.

OVERVIEW & EXECUTIVE SUMMARY

IETA’s comments are structured around three sections. Section 1 features priority input, highlighting top recommendations and concerns with the Proposal. Section 2 features high-level input, generally relevant across all aspects of sound OBPS design and implementation. Section 3 contains detailed input associated with specific sections or elements of the Proposal.

Under Section 1, IETA’s priority input on the Proposal covers the following items:

1A. Usage and expiry limits on compliance units
1B. Voluntary participation and early opt-in
1C. Non-facility market participation
1D. Commitment to a federal offset system
1E. Treatment of electricity under the output-based standard
Under Section 2, IETA’s high-level recommendations can be summarized as follows:

2A. Support flexible compliance and cost-effective approach  
2B. Enable market linkages and Pan-Canadian “cooperation”  
2C. Complement and leverage existing programs  
2D. Recognize use of offsets and credits from existing systems  
2E. Complement international rules and systems  
2F. Consider broader cumulative impacts

Under Section 3, where we provide more technical input on specific Proposal sections, IETA’s input is structured around the following categories:

3A. Coverage and Compliance Period  
3B. Report for a Covered Facility  
3C. Rules for Calculated Output-Based Standards  
3E. Compensation and Compliance Units  
3F. Tracking System  
3G. Coming into Force

SECTION 1: PRIORITY INPUT

The following summarizes IETA’s priority recommendations and concerns with the Proposal.

1A. USAGE AND EXPIRY LIMITS ON COMPLIANCE UNITS

IETA is disappointed to see the proposed 75% quantitative usage limit in the latest Proposal. Subjective quantitative limits restrict cost-containment opportunities and other co-benefits that underpin a broad and liquid carbon market. We believe that all environmental market programs, including Canada’s OBPS, should avoid artificially limiting the use of eligible compliance units, including offsets, for compliance purposes to a specific percentage of an entity’s overall obligation.

IETA requests transparent data and impact analyses be shared by Environment and Climate Change Canada (ECCC), which justifies not only the newly-proposed usage limit of 75% but also the proposed expiry dates. We hope this modeling work includes robust supply-demand analyses under future OBPS scenarios (e.g., including possible changes to the designation of backstop provinces).

Finally, due to the nascent and non-existing market of credits currently available under the OBPS program, IETA also strongly recommends avoiding arbitrary expiry dates on instruments like surplus credits.
1B. VOLUNTARY PARTICIPATION AND EARLY OPT-IN

IETA strongly supports the proposed move to allow industrial entities to “opt-in” to the OBPS at program outset (2019), an earlier window than ECCC’s initial proposal of 1 January 2020. Especially in light of Ontario’s recent transition to a backstop jurisdiction, we applaud ECCC for listening to affected stakeholders and altering its latest Proposal to reflect this input.

We also strongly endorse the aim of the policy “to minimize competitiveness and carbon leakage risks from the exposure of a sector to the federal fuel charge”. To avoid potential competitiveness issues, particularly for electricity, **ECCC should explore removing the lower-end 10ktCO2e opt-in threshold.** This move would allow smaller facilities, should they so choose, the ability to compete directly with larger (OBPS-eligible) peers. It would also allow these actors to participate in the program with flexible, lower-cost compliance options to meet obligations.

In order to accommodate the due diligence and appropriate processes to allow for opt-in, IETA recommends that the final framework include language to enable retroactive application of OBPS provisions for entities that opt-in during the 2019 compliance year (e.g., 2020 credits/rebates towards collected fuel levies from 2019).

1C. NON-FACILITY MARKET PARTICIPATION

IETA strongly supports the inclusion of “non-facility market participants”, as featured on page 36 of the Proposal. The current proposal defines a non-facility market participant as “a broker, an investment company or other persons who wish to participate in the OBPS but do not own or operate a covered facility”. We are pleased to see that ECCC recognizes the need for these critical financial intermediaries, liquidity providers and others to register and create accounts to enable OBPS market participation.

Final regulation must be crafted in manner which ensures that “non-facility market participants” are not unfairly discriminated against should the OBPS program unwind. Fair market competition, including the treatment of all market participants, is absolutely essential to attract market makers and investors.

IETA does not support the delayed timing for OBPS participation by “non-facility market participants”. According to the Proposal, non-facility market participants are only able to register on or after the “increased rate compensation deadline”, identified as 15 February following the second year of the first compliance period. As proposed, these means that vital market players cannot register and participate in the system until 15 February 2021. Once again, we do not support this seemingly arbitrary delay and request that registration for “non-facility market participants”: 1) begin immediately from program outset; and 2) align with registration/participation of other facility participants. We also request clarity from ECCC about the rationale behind the delayed approach, as currently proposed.
1D. COMMITMENT TO A FEDERAL OFFSET SYSTEM

We are encouraged by the Proposal’s provisions for offsets to be directly approved by the federal government for use to meet OBPS compliance obligations. Without a federal offset system that directly approves offset projects, the majority of low-cost mitigation potential of offsets will not be realized as all provinces – with the exception of Alberta, BC and Quebec – are left with no opportunities to generate offsets for the foreseeable future.

We are concerned that ECCC continues to state that a federal offset system remains “under consideration” without formal commitments and communiques. We strongly urge ECCC to deliver a definitive decision to proceed with a federal offset system as soon as possible, and this information should be included in final OBPS regulation. In addition to a definitive system-related decision, ECCC should also clearly communicate steps to support urgent offsets protocol development, adaptation and use. If there exists concern about scarce public resources to support these activities, ECCC can explore several options to resource system administration and protocol work, such as administration fees upon serialization of credits and industry partnerships.

1E. TREATMENT OF ELECTRICITY UNDER THE OUTPUT-BASED STANDARD

With respect to the proposed output-based standard (OBS) for generation of electricity using fossil fuels, IETA welcomes the improvement from ECCC’s October 2018 proposal. However, we continue to see that the fuel differentiated OBS with phased-in thresholds, as currently proposed, may result in adverse outcomes across Canada’s existing and future carbon markets.

SECTION 2: HIGH-LEVEL INPUT & MARKET GUIDANCE

The following summarizes IETA’s high-level input and market guidance on the Proposal.

2A. SUPPORT FLEXIBLE COMPLIANCE AND COST-EFFECTIVE APPROACH

IETA is pleased to see that the principles of ensuring flexibility and cost-effectiveness have continued to guide the latest OBPS Proposal. We strongly support the use of surplus credits and offsets as compliance instruments across backstop jurisdictions. These instruments should be available to compliance entities to meet full regulatory obligations across these regions.

IETA also encourages ECCC to consider enabling language that will allow broader and responsive cost-containment provisions, as jurisdictions and industry adapt to the OBPS in the early years of program implementation. As an example, consider Alberta’s cost-containment program that provided its Ministry with discretion and triggers to adapt to ever-changing global competitiveness conditions.
2B. ENABLE MARKET LINKAGES AND PAN-CANADIAN “COOPERATION”

One of Canada’s top carbon pricing priorities should be the pursuit of flexible and coordinated pricing systems built on market-based trading from coast-to-coast. Final frameworks and guidance should enable – not hinder – linkage (full or partial) across backstop and non-backstop jurisdictions.

The benefits of regional linkages and cooperative approaches are clear: the bigger and broader the market, the wider the range of abatement opportunities and improved efficiencies, thereby driving-down program costs while driving-up clean projects, jobs and market opportunities. Allowing fungible credits across all Canadian jurisdictions must be a key policy outcome and goal for the country.

2C. COMPLEMENT AND LEVERAGE EXISTING PROGRAMS

IETA hopes to see the federal government continue to heavily rely on the experiences, lessons, systems, standards and infrastructure (e.g., registries, exchanges) from existing environmental market programs. Building on, and ensuring complementarity with, established programs will enhance efficiencies, minimize program costs, enable cross-border harmonization, and ensure broader program buy-in and environmental integrity (e.g., avoid double counting). This includes the use and adaptation of existing protocols from compliance jurisdictions, along with completed work on new project types and protocols.

Final regulation should see more prescriptive, enabling language to allow for the Minister to more easily recommend and adopt future linkage opportunities. For example, international market programs under development (e.g. Article 6/ITMOs, domestically-delivered voluntary Certified Emissions Reductions etc.) and existing domestic market programs (e.g., Alberta, Quebec-California programs).

2D. RECOGNIZE USE OF OFFSETS AND CREDITS FROM EXISTING SYSTEMS

We strongly recommend that the federal government allow for the use of offsets and credits (i.e., measurable units already issued by provincial governments in existing programs) be recognized to meet OBPS compliance obligations in backstop jurisdictions.

All existing Canadian provincial compliance units – with federally eligible start and vintage dates – should be considered recognized units from OBPS program outset. Recognizing credits from jurisdictions with established programs will allow Canada to immediately account for reductions “out of the gate”, while mitigating compliance costs for entities in backstop jurisdictions. This approach will also allow backstop jurisdictions to draw upon the experience from regions that currently have effective pricing systems, while developing their own experience and systems in tandem.
The easiest way to enable this form of one-way credit fungibility is to rely on the rules and parameters for offset and surplus credit generation in already-existing systems. This also avoids cumbersome, complicated rules in facilitating the use of these units in backstop jurisdictions (e.g. protocol development).

We believe the criteria for recognized units, as currently proposed, is extremely restrictive and will fail to enable the necessary credit volumes from existing Canadian compliance systems. As such, we urge ECCC to consider less restrictive criteria and relaxed transition provisions, which drive important low-cost mitigation options during early program years.

2E. COMPLEMENT INTERNATIONAL RULES & SYSTEMS

Canada must look beyond its borders to ensure that OBPS rules and systems are complementary and readily adaptable to the world’s quickly changing carbon landscapes. We continue to urge officials to closely track developments that may affect both regional or global “stringency” acceptance of Canada’s approach to carbon rules, pricing and trade.

More specifically, Canada must consider regular alignment within the broader context of global carbon pricing disparity and both regional- and sector-specific nuances for trade exposed facilities. It is important for Canada to create a carbon pricing regime and framework that remains durable over time – achieving this program durability requires regulatory language that empowers government to scale-up (or scale-down) in response to global advancements or withdrawals on climate action and pricing. Ultimately, resilient and responsive policy is essential for balancing global climate ambitions with the economic stability necessary to drive reasonable efficiencies and scale clean investments.

2F. CONSIDER BROADER CUMULATIVE IMPACTS

Harmonizing GHG program rules, tools, standards, and quantification methodologies across affected jurisdictions are key steps in building cross-border cooperation, enabling market and program efficiencies, and streamlining carbon accounting and regulatory approaches. Harmonization also allow business to more easily and cost-effectively plan, comply, and invest. We therefore encourage ECCC to carefully consider how the OBPS will interact with existing and proposed provincial, federal, or international climate policies. Proactive steps to identify friction points or opportunities will prove necessary.

At minimum, we recommend establishing clear metrics and annual process for monitoring the impacts of the OBPS, and how this program interacts with other climate measures. Final OBPS regulation should include enabling provisions that allow for both retroactive and forward-looking corrections or improvements. Metrics may include assessment of unintended impacts on competitiveness or other material adverse effects. All program review, evaluation and modification processes and timetables must be transparently communicated with all affected stakeholders.
SECTION 3: DETAILED COMMENTS ON OBPS PROPOSAL

The following provides more detailed technical input on specific sections of the Proposal.

3A. COVERAGE AND COMPLIANCE PERIODS

IETA supports the application for OBPS facilities that: reside in backstop jurisdictions; emit 50ktCO2e or more per annum; and carry-out an activity for which an OBS is prescribed. We continue to support the proposed approach to not cover: buildings not associated with a covered OBPS facility; landfills not associated with a covered OBPS facility; municipal wastewater treatment facilities; and natural gas distribution pipelines.

We also support annual compliance periods, provided the market infrastructure and compliance unit supply are available to maximize compliance flexibility and least-cost options on an annual basis.

3B. REPORT FOR A COVERED FACILITY

The proposed requirement for covered facilities to submit a report (to include applicable limits, GHG emissions and facility activities) appears sound and defensible. We also support independent third-party verification of the report, recognizing the importance of transparency and verification in ensuring environmental integrity of the system.

IETA welcomes the standardization for verification requirements across jurisdictions. However, some detailed observations and recommendations to improve the Proposal language are highlighted below.

Conflict of Interest: We believe the burden should be placed on the Verification Body (VB) to ensure there is no conflict of interest, but 11(2) puts the burden on the person responsible. Typically, a COI assessment is completed by the VB, and a COI form or statement is submitted as part of the verification report or as a separate document. We also believe the COI should also be assessed against more than “the person” – this needs to include the facility and the owners/operators of the facility, as well as any technical consultants involved in the GHG report. We suggest the Proposal’s COI section be more explicit about what could potentially trigger a medium/high COI situation where a verification could not proceed without mitigation. The currently proposed language sees no limitations, which seems too broad.

Facility Visits & Trigger List: The Proposal’s facility visits section and the lengthy list of potential triggers are welcome. Site visit requirements are often unclear resulting in inconsistent justification and timing by VBs. Clarification upfront in the regulatory framework is noted and appreciated.
ISO Updates & Discrepancies: A major issue that has been regularly noted by IETA’s community and other stakeholders, including at several January 2019 ECCC-hosted information sessions, is that the two (2) International Standards Organization (ISO) documents referenced in the Proposal (i.e., 14064-3:2006 and 14065:2013) are currently being updated. In Canada’s final OBPS regulation, we recommend inserting language similar to “or the most recent version of 14064-3/14065” or developing another mechanism to incorporate updated ISO standards into the final framework.

Allow Qualified Positive Statements: In the Proposal, there appears to be no reference to the “types” of required verification statements (and only one mention of adverse statement). We believe that qualified positive statements should be allowed, where a VB can still confirm that the reported emissions/products are materially correct, but the facility is not meeting some other requirements. These scenarios typically occur related to missing data substitution methods, the use of simplified reporting methods or emissions estimation methods not found in a regulation, or the facility not meeting QA/QC requirements. Ontario, BC, California, and other existing programs allow these types of qualified positive verification statements.

3C. RULES FOR CALCULATED OBS STANDARDS

Ensuring competitiveness should continue to be assessed using appropriate peer groups and sample sizes. We also recognize that unique approaches may be required to accommodate specific sectors, products and facilities under the final OBPS.

To protect the competitiveness for opt-in facilities or EITE facilities without an OBS (or an unfair OBS), IETA recommends having a clear process and criteria over the first year of OBPS implementation to adjust or implement an OBS or benchmark applicable for 2019 calendar year compliance. This is a valuable design approach, even if applied retroactively.

ECCC may also want to consider transitional benchmarks to provide ECCC and industry enough time to arrive at a reasonable and fair OBS, or for adjustments to prescribed OBS before the November compliance deadline for 2019 calendar year compliance.

3D. COMPENSATION AND COMPLIANCE UNITS

Under the OBPS, IETA supports maximum compliance flexibility with timely access to, and usage of, surplus credits and offset credits. We encourage deeper exploration of linkage options with OBPS markets, one-way or two-way linkages with other Canadian carbon pricing jurisdictions, and openness to international linking opportunities to help increase availability and flexibility for offset and surplus credits. Several discrete market design recommendations to ECCC are summarized below.

Surplus Credits: IETA supports the issuance of surplus credits to covered facilities that emit less than the applicable GHG emissions limit. Surplus credits are important in not penalizing facilities for driving early action, real GHG reductions, and enabling trading across existing and future market programs.
**Retirement of Compliance Units:** We support the retirement of remitted compliance units to compensate for excess emissions. This is important to maintain system integrity and avoid double-counting. We support an 8-year expiry period to be consistent with the Alberta system. However, we recommend that any expiry of compliance units be assessed against the forecast of demand once the size of a linked market is determined. This must be achieved to ensure that access to supply does not incent excess banking or unnecessarily trigger cost-containment concerns.

**Linking & Broadening Pool of Compliance Units:** Linking OBPS jurisdictions and either one-way or two-way linkages with other Canadian or international jurisdictions will help regulate bottlenecks, supply constraints and upward pricing pressures. We recommend broadening the pool of available offsets or surplus credits to other jurisdictions as sound approach to combat cost and competitiveness concerns.

**Limitation on Use of Compliance Units:** IETA is concerned with the introduction of a limitation on the use of compliance units beginning in 2021, allowing for up to 75% of compliance units to compensate for a facility’s excess emissions. Subjective quantitative limits restrict cost-containment opportunities and other co-benefits that underpin a broad and liquid carbon market. Once again, we request removal of this quantitative usage limit in the final framework. We further request ECCC to share underlying data/assumptions on OBPS supply-demand scenarios with (and without) various usage constraints.

**Leakage Determination in Offset System:** Section 28(4)(g) specifies that protocols should require assessment and mitigation of leakage risks be undertaken by project proponents. In many cases, leakage is better assessed and managed at a protocol level. It can often be excessively burdensome to also assess and manage at a project level. We ask that ECCC consider leakage assessment and management be conducted at either a protocol or project proponent level, depending on the protocol requirement.

### 3E. TRACKING SYSTEM

We generally support the tracking system provisions in the Proposal, but clarity is required prior to finalization of OBPS regulation. Naturally, assurance across affected participants about core infrastructure design and access is fundamental to achieve workable policy and drive market confidence. Participants need clarity to confidently allow for compliance planning and trading preparation – not only across the federal OBPS system but also potential coordination across relevant existing provincial programs.

**IETA recommends bilateral arrangements and regional tracking systems as the first system for tracking compliance units.** Until linkage opportunities are clear and immune from risks to political changes, we recommend emphasizing maximized access before focusing on applicability of uniform platforms.
We urge ECCC to streamline duplicative reporting timelines and requirements. The administrative costs of the proposed OBPS extends beyond data entry and tracking, and includes downstream administration for reconciliation, revisions, etc. For example, current requirements for covered facilities to receive then forward proof of payment for Excess Emissions Charges seem ad-hoc and could be streamlined or simplified by coordinated reporting with CRA, deferred confirmation on subsequent compensation reports, etc. Such simplification will help mitigate potentially time-consuming administration and reconciliation efforts for ECCC, industry and CRA.

Finally, we strongly support the ability for “non-facility market participants”, as featured on page 36 of the Proposal. The current proposal defines a non-facility market participant as “a broker, an investment company or other persons who wish to participate in the OBPS but do not own or operate a covered facility”. We are pleased to see this window for critical market makers, intermediaries etc. to register and create OBPS accounts to participate in the market. However, the timing on when these market participants can register in the system needs to be adjusted to match all other market participants.

3F. COMING INTO FORCE

We request that ECCC provide further clarity about how precisely “…the Act (GGPPA) permits the (OBPS) regulations to have an effect earlier than the day on which they are made”.

Also, as provinces and territories develop and adopt their respective carbon programs, the legislative and/or regulatory processes for adding, modifying, or removing the applicability of the GGPPA (including OBPS) remains unclear and inconsistently communicated across potentially affected regions and stakeholder groups. We urge ECCC, ideally in tandem with sub-national government peers (e.g., Ontario), to remedy the current confusion and communications’ inconsistencies as soon as possible.

CONCLUSION

Once again, we appreciate this opportunity to record our comments on the federal government’s OBPS regulatory framework proposal.

If you have questions, or require further information, please contact IETA Managing Director, Katie Sullivan, at sullivan@ieta.org.