IETA COMMENTS ON CLEAN FUEL STANDARD REGULATORY DESIGN PAPER


ABOUT IETA

For two decades, IETA has been the premier international business voice on climate markets and finance, including the design and implementation of flexible, compliance trading programs to address climate change. Our multi-sector non-profit organization represents over 150 companies, including many facing risks and opportunities across Canadian fuels’ and industrial sectors.

IETA’s market and technical expertise is regularly called-upon to inform market-based policies that deliver incremental greenhouse (GHG) reductions, minimize carbon leakage, address economic competitiveness concerns, and balance economic efficiencies with social equity and co-benefits. We believe that a robust, trading and crediting system should form the backbone of Canada’s CFS, with a view to driving efficiencies, least-cost compliance, low-carbon innovation and investments.

1. PRIORITY INPUTS

In response to the CFS Regulatory Design Paper (the Paper), IETA encourages ECCC to consider the following priority inputs:

1. Enable broad market participation.
3. Do not give preferential treatment to specific fuels/technologies.
4. Provide fuel producers with optionality to calculate certain CI values.
5. Do not include cross-stream trading limits.
6. Assess the impacts of depositing credits without implementing proper verification.
7. Avoid annual verifications of credit transfer forms.
8. Additional considerations.

IETA’s comments are the result of deep experience and lessons learned across North American and global environmental market programs. Our input is also informed by recent informal discussions across both Canadian federal and various provincial governments and experts. Our insights are a testament to the iterative – yet increasingly robust and aligned – nature of practical, least-cost market solutions to tackle the climate and other environmental challenges.
2. DETAILED COMMENTS

1. ENABLE BROAD MARKET PARTICIPATION

IETA believes that Canada’s CFS regulatory framework must enable broad participation that allows market participants to decide on reduction and crediting opportunities. We are therefore concerned to see the Paper propose a minimum credit generation threshold (at a company level) of 10 kilotonnes (kt) per year by project type for Compliance Category 1.

Although we understand this proposed threshold approach aims to reduce administrative burdens, evidence suggests that such a provision could significantly limit supply in a likely constrained market. The regulation should facilitate the maximum generation of credits and allow market dynamics be the driver of project generation. This is an important consideration, particularly since the California Low Carbon Fuel Standard (LCFS) experience shows the average trade size is 5,000 tonnes, suggesting there may be interest in projects generating 10kt per year.

The provision, as currently proposed, also runs counter to ECCC’s request for feedback about whether other parties acting on behalf of small credit generators or aggregators of credits should be allowed to participate in the system under limited conditions. If ECCC is strongly considering imposing a minimum credit generation threshold by project type, aggregation will be needed and third-party aggregators must be allowed to participate in the market. Otherwise, it will result in either stranded credits or no credit creation from smaller projects where the aggregate can add up.

2. RECONSIDER EARLY ACTION CREDITS BEFORE 2020

Early action credits send strong and important market signals of supply availability. Enabling these units will drive investor confidence and provides compliance entities with clear incentives to identify – and act upon – low-hanging, internal GHG abatement opportunities.

Not only is “early action” not defined in the Paper, but the proposal also lacks any guidance on what would constitute the start of early action (e.g. start of operations, etc.). Clear definitions and guidance must be featured in future CFS program communications.

The Paper further states that early action credits will “only be allowed from each fuel stream beginning on the date of publication of the final regulation for the liquid stream (expected in 2020)”, despite a baseline year of 2016 being proposed to impose carbon intensity (CI) reductions. We encourage ECCC to consider providing early action for activities that took place beginning in 2017. This revised date will help with the creation of credit supply while recognizing early actors that made clean investments which led to real measurable GHG reductions.
We note that, according to the Paper, there is no opportunity for the liquid stream to earn early action credits. **This implies that the proposed mechanism only favours the gaseous and solid streams** (notwithstanding how the liquid fuel stream bears 23MT out of the total 30MT envisioned under the CFS).

3. **DO NOT GIVE PREFERENTIAL TREATMENT TO SPECIFIC FUELS/TECHNOLOGIES**

The ultimate framework must align with overarching CFS guiding principles. According to the Paper, ECCC is proposing the use of a multiplying factor for credits in order to promote greater adoption of renewable jet fuel. The creation of additional credits favouring one technology, fuel or sector over another must be backed and justified by reasonable, defensible and objective criteria. Failure to do so can lead to negative impacts on supply and credit price. **In IETA’s deliberations, we cannot see a credible pathway that would support the basis of a multiplier and special treatment for a specific fuel or technology.**

4. **PROVIDE FUEL PRODUCERS WITH OPTIONALITY TO CALCULATE CERTAIN CI VALUES**

As currently proposed, the regulation would not differentiate crude oil or natural gas-derived fuels regardless of how those fuels are produced. In reality, there is significant variance in the amount of “embedded” carbon of crude oil and natural gas, depending on the energy inputs needed for production and transport, fugitive methane emissions at the well, and other parameters. These “upstream” GHG emissions can easily override downstream emissions, thereby negating the accuracy and value of ECCC CI modeling. Further, producers of oil and gas who invest in technology and operational controls to minimize emissions would not be incentivized.

Rather than rely on default emission factors for all types and sources of crude oil and natural gas, we recommend that fuel producers be given the option to calculate source-specific CI values for upstream and midstream segments of the lifecycle. Under this option, the onus would be on producers to provide complete documentation including primary data quantification methodology that has been validated by a third-party and accepted by ECCC. This approach may also minimize the need for ECCC to develop protocols for Compliance Category 1.

5. **NO CROSS-STREAM TRADING LIMITS**

IETA supports strong rules and regulatory frameworks that drive broad market participation and liquidity. Based on the Paper, it is unclear whether there will be time – or other – limitations on credit banking. **We urge ECCC to not impose time limit(s) or other banking/crediting use constraints on market participants.**

We also urge ECCC to avoid all regulated limits on CFS cross-stream trading. It is not clear from the Paper where the basis for the proposed 10% limit originated, or why officials deemed this level appropriate without robust data and supply-demand analyses to support this language. Has ECCC in fact carried-out these in-house scenarios and impact analytics? **Once again, to complement the liquidity provisions and overall functioning of the market, we encourage ECCC to remove any barriers to cross-stream trading.**
6. ASSESS IMPACTS OF DEPOSITING CREDITS WITHOUT PROPER VERIFICATION

Timing of credits to market is critical towards building a robust environmental compliance market. IETA appreciates ECCC’s proposed timeline of 10 days to deposit credits after the Fuel Transaction Report is received. However, Annex II (CFS credit lifecycle process diagram) shows annual third-party verification could be required after the credits have been deposited into a party’s credit account; and may have been banked or traded. We urge ECCC to revisit this proposed process.

*We strongly discourage ECCC to issue CFS credits in advance of verification.* Post-verification issuance will undermine credit validity and introduce risk into the nascent market. This would also result in poor market activity and low levels of confidence, featuring delayed credit monetization while hindering market transactions.

**ECCC is also encouraged to consider the impact that post-issuance verification could have on credits generated by activities that are also eligible for credit generation in other federal and provincial carbon pricing systems.** Verification needs to be in place before the credits are banked or traded, and market participants must have high degrees of certainty that there will be no revocation, clawback, or invalidation of credits.

Certainty of reductions also needs to exist as it can impact provincial targets. For example, the proposed *Made-in-Ontario Environment Plan*, currently undergoing consultation, appears to have a heavy estimated reliance on the federal CFS to achieve Ontario’s 2030 reduction target (i.e., CFS accounts for 7.0% source of reductions).

7. AVOID ANNUAL VERIFICATIONS OF CREDIT TRANSFER FORMS

The proposed requirement to have annual verification of credit transfer forms seems unreasonable and potentially onerous and costly to participants. **Annual verification of credit transfer forms is not common practice in other existing environmental credit registries.** In most cases, a seller initiates transfer of credits from their account to counterparty, registry operators then facilitate the transfer while maintaining transfer records. This tried and true model guarantees the integrity of credit transfers.

We understand that ECCC has communicated its intention to contract the development and implementation of a registry to support CFS (i.e., RFI from 21 December 2018). The future CFS registry will have to be designed to facilitate transfers and retain transfer records, thereby voiding the requirement for any third-party verifications of credit transfer forms.

*If ECCC is, for whatever reason, committed to the proposed approach, IETA requests clear explanation and rationale behind the proposed departure from this regular environmental market practice.*
8. ADDITIONAL CONSIDERATIONS

Below briefly summarizes a selection of additional points and considerations on the Paper.

- **IETA supports the Paper’s transparency proposal** to publish numbers on credit generation, use, trade, and price. Transparency could also be supported by publication of credit/deficit generation and CI reports.

- **It remains unclear whether credits generated based on CI value**, which are subsequently revoked or updated, are also revoked and/or need to be replaced.

- The Paper proposes allowing surplus to be carried-forward into the next compliance period, with a maximum carry-over of 2 years and a 20% interest penalty. **How was this proposed 20% annual interest penalty was determined?**

- Other CFS compliance mechanisms that appear to be under consideration including: a Credit Clearance Mechanism (CCM); and a CFS Emissions Reduction Fund (ERF).

- **Regarding CCM**: to date, we see insufficient empirical evidence – across jurisdictions with existing low-carbon fuels markets – to support CCM as an effective program design element for Canada’s CFS. In California, CCM has only been used once – and its effectiveness remains under review by California Air Resources Board (CARB) regulators. To date, the California CCM has provided very little incentive for compliance entities to participate vis-à-vis market dynamics. It takes credits out of the market once pledged, while tying the seller to a maximum price set by CARB. This price could be lower than the market price, which would not be beneficial to the seller. Similarly, if the price in the market is lower than the maximum set price, then there is no incentive for the buyer to buy in the CCM.

- **Regarding a ERF**: we agree that such a fund can play an important role as a compliance mechanism that supports low-carbon investment activities and transition over time. Other jurisdictions – across North America and internationally – earmark and disburse revenue from compliance pricing systems to support clean technology, innovation, and other forms emissions reductions initiatives. The financial structures, eligibility criteria, metrics, outcomes and governance standards of existing models should be carefully reviewed and assessed to inform the CFS ERF. IETA remains on-hand to support future ECCC discussions about lessons learned and best practices to inform future CFS ERF design, operationalization and governance.
CONCLUSION

Once again, we appreciate this opportunity to record our comments on the CFS Regulatory Design Paper.

IETA looks forward to future engagement with the CFS Team and ECCC.

If you have questions, or require further information, please contact Rina Cerrato at cerrato@ieta.org.