



# ONTARIO CHAMBER OF COMMERCE SUBMISSION CAP AND TRADE DESIGN OPTIONS December 15, 2015

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Subject : Cap and Trade Program Design Options (EBR Registry Number: 012-5666)

Dear Ms. Ollevier,

Thank you for the opportunity to comment on the design options under consideration for Ontario's incoming cap and trade system, which were released publicly in November 2015.

For more than a century, the Ontario Chamber of Commerce (OCC) has been the independent, non-partisan voice of Ontario business. Our mission is to support economic growth in Ontario by defending business priorities at Queen's Park on behalf of our network's diverse 60,000 members. We represent local chambers of commerce and boards of trade in over 135 communities across Ontario, steering public policy conversations provincially and within local communities.

As outlined in the OCC's recent report, *Clean Profits*, Ontario's business community understands the need to address climate change. If designed correctly, the Province's cap and trade system could provide significant economic and environmental opportunities. If designed poorly, however, we could see the opposite.

Above all, to design and implement an effective cap and trade system, businesses need to be part of the solution. This demands a design process that provides certainty and transparency for the business community. Without knowing how cap and trade could impact their bottom line, businesses looking to invest and expand in Ontario face an ambiguous decision-making environment.

As such, the OCC appreciates the government's decision to publicly release the design options for cap and trade currently under consideration.

Instead of responding to each of the government's questions individually, we have decided to focus our comments on five key design areas. The remainder of this submission provides this commentary.

## 1) **Competitiveness**

In *Clean Profits*, the OCC noted that, when it comes to cap and trade, many businesses are concerned that the system could negatively impact their competitiveness. This is due to the rising cost of doing business in Ontario, the potential for regulatory fragmentation within Canada, and the possibility of moving out-of-step with major

North American competitors. To address this concern, we called on the government to distribute free allowances to accommodate those sectors that are most exposed to a carbon price, and to develop a set of objective and transparent criteria to do so.

As such, the OCC strongly supports the government's proposed option to distribute allowances free of charge to a portion of covered emitters, as well as the use of transparent criteria to determine which emitters would qualify for these free allowances. In particular, we are supportive of the proposal of a 100 percent Assistance Factor for all industrial and institutional sectors in the first compliance period, which recognizes that these sectors will need time to transition to a business environment that includes cap and trade.

The OCC also appreciates the government's proposed intent to recognize the actions that some businesses have already taken to reduce their greenhouse gas (GHG) emissions in Ontario. Without this recognition, businesses that have already demonstrated leadership on climate change could be put at a disadvantage, as lower cost options to reduce their carbon output may have already been employed.

The OCC therefore supports the development of an early reduction allowance program, but the program has to be meaningful for firms who have achieved significant emissions reductions in Ontario. Ontario's GHG reporting requirement for large emitters began in 2010, meaning that reductions would only be captured by government reporting data starting in 2011. However, there are companies in Ontario who took action to reduce their GHG emissions before the reporting requirement was in place.

We recognize the difficulties of validating emissions reductions that predate the government's reporting requirements. If the government does move ahead with an early reduction allowance program, we urge it to work with relevant stakeholders on a process for validating earlier emissions reductions.

Finally, OCC members are concerned by the government's proposed option to cover both fixed process and combustion emissions in the system. Fixed process emissions are emissions that arise from the chemical and physical reactions that take place in certain industrial processes, like cement and steel making, and are not attributable to combustion or energy production. As a necessary by-product of these reactions, fixed process emissions are in most cases unavoidable and irreducible. As a result, the government should consider excluding fixed process emissions from the system for at least the first compliance period.

## **2) Timing**

According to the design options document, the government's proposed option is to launch Ontario's cap and trade system on January 1, 2017. Presumably, this start date will allow Ontario to link with Quebec and California at the start of the next compliance period in 2018, while also providing a buffer year for covered entities to become familiar with the system.

This means that the proposed start date is less than 13 months away. For the business community, this is a very tight deadline, especially when many of the details of the cap and trade system remain unconfirmed. While the design options document does provide business with a sense of where the government could be going by identifying proposed options, it does not contain any firm decisions. It may be that government has already made firm design choices for some parameters, but these are impossible to determine from the document. As a result, uncertainty around system design remains a concern. If it does intend to meet its proposed start date, the government needs to create more certainty for businesses by making more firm design decisions soon.

At the same time, the government should not rush design choices to meet its proposed launch date at the expense of effective program design. Ontario's economy is different from both Quebec and California, and so time needs to be taken to ensure that the cap and trade system is appropriately tailored to the Ontario context. In addition,

neither Quebec's, nor California's cap and trade system is perfect. In fact, California is currently undertaking a review process to understand the strengths and weaknesses of its system and develop regulatory amendments for the third compliance period and post-2020. Specific topics for review include allowance allocations, the impact of the system on carbon leakage, and the offsets program. If Ontario moves too quickly, there is a risk that it could adopt system features from these jurisdictions that are in need of improvement.

As a result, we urge the government to take sufficient time to make the choices that result in the design and implementation of an effective cap and trade program. Ontario has an opportunity to improve upon the design of similar systems in other jurisdictions. If the government is confident that it can produce an effective design in time for a January 1, 2017 launch date, then we urge it to provide clarity on cap and trade design parameters as soon as possible.

### **3) Cap and trade proceeds/revenue**

The design options document does not reveal any new information about the revenue that will be generated by the cap and trade system. Instead, it reiterates commitments made in previous announcements to reinvest the revenue in GHG-reducing programs and assist Ontario households and businesses in the transition to a low carbon economy.

If used effectively, these proceeds will play an important role for government in achieving its environmental and economic goals. Alongside a price signal to incentivize emitters to reduce their GHG emissions, there will need to be considerable capital investment to replace Ontario's more carbon-intensive capital stock. To drive emissions reductions in the near term, replacement of this capital will need to happen quickly. Government can greatly increase the effectiveness of the cap and trade system by using the proceeds to assist this transition.

In the *2015 Ontario Economic Outlook and Fiscal Review*, the government outlined that the cap and trade system is projected to generate \$0.3 billion in revenue in 2016-17 and \$1.3 billion in 2017-18. In addition, the government has committed a portion of this revenue to create the Green Investment Fund, which will be available in 2015-16 to support GHG-reducing investments.

Even with this new information, there remain outstanding details, including how the remaining revenue will be used and how the allocation of revenue will be administered. These questions must be answered quickly to ensure that the programs and policies that will help businesses, households, and others adjust to cap and trade are available when the system launches.

As recommended in *Clean Profits*, the OCC urges the government to direct cap and trade revenue towards efforts that directly facilitate businesses' transition to a lower carbon economy, such as investments in low-carbon processes, technology, and other capital.

Cap and trade proceeds should not be directed into general government revenue. It is important that the allocation of the revenue be objective and transparent. To increase transparency, the government should consider the creation of an arms-length organization to administer this revenue.

In addition, the government needs to clearly define the principles that it will adopt when deciding how to invest revenue from the cap and trade system. At a minimum, these investments will need to fund activities that achieve incremental GHG reductions.

#### **4) Complementary measures**

The design options document also contains no new details about complementary measures that might be implemented alongside the cap and trade system. Complementary measures are critical components of an overall climate change strategy, as GHG reductions generated by the cap and trade system alone will not be sufficient to achieve Ontario's long-term targets. To meet these targets, reductions will need to be realized from all emitting sectors, including transportation, buildings, and industry. This demands a suite of policies that include, but is not limited to, cap and trade.

At the same time, it is important that complementary measures be truly complementary; that is, they should not undercut the main advantage of a broadly-scoped cap and trade system—generating economy-wide emissions reductions at the lowest cost.

Given the importance of these complementary measures in moving Ontario towards its emissions reductions goals, and the potential impact they would have on the efficiency of cap and trade, the OCC encourages the government to host a separate set of discussions on complementary policies beyond the single question that is posed in the design options document. In the same spirit as this exercise, it should also publicly share any complementary policies that are currently being considered.

#### **5) What does cap and trade look like post-2020?**

As stated earlier, the OCC appreciates the release of this design options document, which provides a clearer picture of what the incoming cap and trade system could look like during the first compliance period. However, the document reveals few details about what the system might look like beyond this period. For businesses covered by the cap and trade system, their facilities represent large-scale investments and involve planning decisions that extend beyond a single, three-year compliance period. Understanding what the long-term environment will look like under cap and trade is essential information as these businesses plan for the future, as well as other firms looking to make these large capital investments in Ontario.

Take the allocation of free allowances as an example. The government's proposed option to offer free allowances with a 100 percent Assistance Factor for all industrial and institutional sectors during the first compliance period will help mitigate their exposure to the carbon price. But, will free allowances be available in the next compliance period? If so, will it be at the same level, or will free allowances be reduced? How much will they be reduced by? Business will need answers to these questions in order to make their long-term investment decisions.

As such, as the government moves ahead with the design of its cap and trade system, the OCC urges it to, where possible, increase the clarity of system design for a longer time period.

In addition, we repeat our call in *Clean Profits* for the government to release an economic analysis of the cap and trade system that demonstrates the costs and benefits of the proposed system for Ontario's economy. To help the business community understand and plan for the long-term effect of the system, this analysis should incorporate the impact of the government's post-2020 targets.

#### **Conclusion**

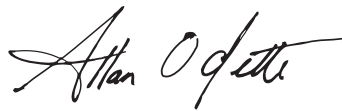
If designed correctly, Ontario's proposed cap and trade system could present significant economic opportunities for the province. As such, the OCC appreciates this opportunity to provide feedback on the design options currently under consideration by government.

As alluded to in the submission, we support the government's proposed option to provide free allowances and

the potential for early action credits, both of which will help the business community transition to the new system. That said, there remain a number of critical design elements that were not addressed in this document.

We encourage the government to continue to engage with the OCC and the broader business community as it moves ahead with the design and implementation of the cap and trade system. Continued engagement with businesses is essential to creating a system that helps the government achieve its environmental ambitions while fostering the conditions necessary for economic growth and prosperity.

Sincerely,



Allan O'Dette  
President & Chief Executive Officer  
Ontario Chamber of Commerce

#### **About the Ontario Chamber of Commerce**

For more than a century, the Ontario Chamber of Commerce (OCC) has been the independent, non-partisan voice of Ontario business. Our mission is to support economic growth in Ontario by defending business priorities at Queen's Park on behalf of our network's diverse 60,000 members.

From innovative SMEs to established multi-national corporations and industry associations, the OCC is committed to working with our members to improve business competitiveness across all sectors. We represent local chambers of commerce and boards of trade in over 135 communities across Ontario, steering public policy conversations provincially and within local communities. Through our focused programs and services, we enable companies to grow at home and in export markets.

The OCC provides exclusive support, networking opportunities, and access to innovative insight and analysis for our members. Through our export programs, we have approved over 1,300 applications, and companies have reported results of over \$250 million in export sales.

The OCC is Ontario's business advocate.