

## Environmental Law

November 23, 2015

### Ontario Unveils Proposed Cap and Trade System

On November 16, 2015, the Ontario Ministry of the Environment and Climate Change (MOECC) released preliminary plans for its proposed cap and trade system. The system, if implemented, would make businesses in key industries responsible for their emissions starting on January 1, 2017. The document, entitled *Cap and Trade Program Design Options*, aims to generate feedback that will assist the province in drafting cap and trade regulations. The MOECC is accepting comments until December 15, 2015.

#### The Proposed Cap and Trade System

The proposed system, if implemented, would impose an emissions cap on facilities in regulated sectors as of January 1, 2017. The aim in the first year is to maintain, rather than reduce, overall emissions. Thus, the initial cap would be set based on forecasted emissions levels in 2017. Beginning in 2018, the cap would decline 3.7% each year, making emissions standards more stringent over time.

Entities in regulated sectors that expect to exceed the emissions cap would be able to purchase emissions allowances through an auction process. The auctions would be conducted as single-round, sealed bids; prospective purchasers would submit a one-time confidential bid, with the sale going to the highest bidder.

The first auction is proposed to take place in March 2017. Subsequent auctions would take place quarterly. To link the Ontario system to similar cap and trade regimes, the quarterly auctions would be held jointly with Quebec and California. Provincial proceeds from allowance auctions will be re-invested to achieve further emissions reductions.

Once purchased at auction, allowances would be tradeable between entities. The province has disclosed few details about the mechanics of the trading system. As an alternative to trading unused allowances, entities can “bank” them for use in a future compliance period.

The province recognizes that the cap and trade system will impose new operating costs on businesses in Ontario, and that some of those businesses may be tempted to shift production to jurisdictions with less stringent environmental policies. In an effort to prevent such “leakage”, the province proposes to distribute a number of allowances to large emitters free of charge.

#### Regulated Sectors

The emissions caps are proposed to apply to a wide range of sectors. Facilities in the following sectors would be subject to the cap and trade scheme:

- electricity, including imported electricity for consumption in Ontario;
- industrial and large commercial (e.g., manufacturing, base metal processing, steel, pulp and paper, and food processing);
- institutions;
- fuel transportation, including propane and oil; and
- distribution of natural gas (e.g., heating fuel).

#### Offset Credits

The province also proposes to establish an offset system for entities that operate outside of the regulated sectors. When such entities invest in emissions-reducing or emissions-removing projects, the province will recognize those contributions through offset credits. The credits can then be sold to regulated entities to “offset” any emissions in excess of the cap. As in Quebec and California, offsets would only be allowed to account for 8% of a facility’s total compliance obligations.

# Goodmans<sup>LLP</sup> Update

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## **Enforcement and Penalties**

Entities with emissions levels that exceed the cap would be subject to a three-to-one allowance penalty. In other words, if an entity does not have sufficient allowances or offsets to cover its emissions in excess of the cap, it would be forced to forfeit three allowances for each allowance it is short. Continued non-compliance could result in suspension of the entity's allowance account, effectively preventing it from using allowances to meet its emissions cap in the future.

The province would also have the authority to impose monetary penalties for non-compliance.

## **Next Steps**

The MOECC is seeking feedback on the cap and trade system outlined in its proposal. Comments received on or before December 15, 2015 will inform the drafting of regulations that will implement the system.

For further information about the proposed cap and trade system, please contact any member of our Environmental Law Group.