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CANADIAN CARBON PRICING: WHERE IS IT GOING?

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On June 15, 2018, then Premier-designate Doug Ford announced that Ontario would not participate in the quarterly cap and trade allowance auction as part of the linked California-Quebec-Ontario Cap and Trade system (**WCI System**),² and thereby triggered the rapid repeal and demise of Ontario's cap and trade, carbon pricing system (**CT System**) 18 months after it began. The announcement was followed by directions to the Independent Electricity System Operator (**IESO**) to dismantle the GreenON website and cancel funding for all green projects that were slated for funding from the \$2.8 billion in dedicated funds from all cap and trade allowance auctions to date, with the exception of certain home retrofit projects. Each of these actions took place swiftly after the Ontario election wherein the Ford-led Progressive Conservatives won a 76-seat majority government and having run on a surgically-focused policy platform that included repealing Ontario's cap and trade system. That same election saw the New Democrat Party become the official opposition, with 40 seats; the Green Party win its first seat in Ontario; and the Liberals, after governing for a 15-year period, reduced to seven seats and without official party status.³ All of these actions took place before the new government was sworn in on June 29, 2018.

The dismantling of Ontario's CT System

continued with the California Air Resources Board (**CARB**) suspending all WCI System trading in cap and trade compliance units from Ontario registered accounts on June 15, 2018.⁴ The Ford government then introduced Ontario Regulation 386/18 on July 3, 2018, to repeal Ontario Regulation 144/16 (the **CT Regulation**) and prohibit registered participants from acting to "purchase, sell, trade or otherwise deal with emission allowances and credits."⁵ Then, on July 25, 2018, the Ford government introduced Bill 4, *Cap and Trade Cancellation Act, 2018*. Bill 4, if passed, will repeal the *Climate Change Mitigation and Low-carbon Economy Act, 2016* (the **CT Act**) and formally end the province's cap and trade program.⁶ The legislation provides for the (i) retirement and (ii) cancellation of Ontario emission allowances, Ontario credits, and Quebec and California emission allowances, offset credits, and early reduction credits (**Cap and Trade Instruments**)⁷ in the following manner:

- i. Cap and Trade Instruments that were held in the cap and trade accounts of an Ontario participant on July 3, 2018 — the date on which Ontario Regulation 386/18 entered into force — and that are not classified with or assigned a vintage year of 2021 are eligible for retirement.⁸ The number of eligible Cap

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² Office of the Premier-designate, Government of Ontario, News Release, "Premier-Designate Doug Ford Announced an End to Ontario's Cap-and-Trade Carbon Tax" (15 June 2018), online: <<https://news.ontario.ca/opd/en/2018/06/premier-designate-doug-ford-announces-an-end-to-ontarios-cap-and-trade-carbon-tax.html>>.

³ Justin Giovannetti, "Ontario PCs romp to comfortable majority as NDP forms the official opposition", *The Globe and Mail* (7 June 2018), online: <<https://www.theglobeandmail.com/canada/article-ontario-pcs-romp-to-comfortable-majority-as-ndp-forms-the-official/>>.

⁴ California Air Resources Board, Market Notice, "New Functionality in CITSS" (15 June 2018), online: <<https://arb.ca.gov/cc/capandtrade/auction/marketnoticejune2018.pdf>>.

⁵ O Reg 386/18.

⁶ Bill 4, *Cap and Trade Cancellation Act, 2018*, 1st Sess, 42nd Leg, Ontario, 2018 (first reading July 25, 2018).

⁷ *Ibid*, s 1(2).

and Trade Instruments actually retired will be that number that is equal to, or, as applicable, less than, the aggregate amount of all greenhouse gas emissions attributed to a participant in respect of a time period to be prescribed by regulation.⁹ Cap and Trade Instruments held by a participant that are in excess of the aggregate amount of all greenhouse gas emissions attributed to a participant in respect of a time period to be prescribed by regulation will not be retired.¹⁰

- ii. All Cap and Trade Instruments held in the cap and trade accounts of an Ontario participant on July 3, 2018 — other than those Cap and Trade Instruments that are retired (see above) — will be cancelled.¹¹ All Cap and Trade Instruments created under the CT Act and never distributed will also be cancelled.¹²

The government will pay compensation to an Ontario participant for the number of Cap and Trade Instruments that is equal to the number of Cap and Trade Instruments held in the participant's cap and trade accounts that are cancelled (see above), less the number of emission allowances that were distributed free of charge to the participant, and less the number of Cap and Trade Instruments held in the participant's cap and trade accounts that are classified with or assigned a vintage year of 2021.¹³

The amount of compensation payable will be determined in accordance with forthcoming regulations, which may prescribe certain criteria that must be met or circumstances that must apply in order for compensation to be paid.¹⁴

No compensation will be paid to the following participants (unless otherwise provided for by regulation):

Market participants;

- Participants registered with respect to the importation of electricity into Ontario for consumption in Ontario;
- Participants registered with respect to the distribution of natural gas in Ontario;
- Participants registered with respect to operation of equipment related to the transmission, storage, and transportation of natural gas;
- Participants registered with respect to the supply of petroleum products for consumption in Ontario; and
- Participants registered with respect to the operation of equipment for a transmission system within the meaning of subsection 2 (1) of the Electricity Act, 1998 and that has been issued an order under subsection 78 (1) of the Ontario Energy Board Act, 1998.¹⁵

The draft legislation seeks to bar causes of action and proceedings arising out of the cancellation of Ontario's cap and trade program.¹⁶

The draft legislation also requires that the government establish targets for the reduction of greenhouse gas emissions in Ontario and allows the government to revise those targets from time to time.¹⁷ Additionally, the Minister of Environment, Conservation and Parks (the **Minister**) is required to prepare a climate change plan, to be accompanied by regular progress reports.¹⁸ The legislation provides the Minister with the option of appointing an advisory panel for the purpose of preparing the climate change plan.¹⁹

During this tumultuous period, the federal government passed its *Greenhouse Gas Pollution Pricing Act* imposing a carbon tax backstop on emitters in provincial jurisdictions — now

⁸ *Ibid.*, s 6(1).

⁹ *Ibid.*, s 6(2).

¹⁰ *Ibid.*

¹¹ *Ibid.*, s 7, para 1.

¹² *Ibid.*, s 7, para 2.

¹³ *Ibid.*, s 8(1).

¹⁴ *Ibid.*, ss 8(2)-8(3).

¹⁵ *Ibid.*, s 8(4).

¹⁶ *Ibid.*, s 10.

¹⁷ *Ibid.*, s 3(1).

¹⁸ *Ibid.*, ss 4(1) and 5(1).

¹⁹ *Ibid.*, s 4(2).

ostensibly including Ontario — that have not implemented a carbon pricing system by 2019.²⁰ Federal Minister of Environment and Climate Change Catherine McKenna confirmed that, in the absence of an equivalent carbon pricing scheme, the federal backstop will apply in Ontario.²¹ However, on July 19, 2018, at the summer meeting of the Council of the Federation, Ontario announced that it will intervene and join Saskatchewan in its constitutional reference, challenging the federal government's ability to impose a carbon tax in the provinces.²² Minister of Environment, Conservation and Parks Rod Phillips and Attorney General Caroline Mulroney further announced, on August 2, 2018, that the Government of Ontario will take steps to challenge the constitutionality of the federal backstop by commencing a reference to the Ontario Court of Appeal.²³ The government indicated that Ontario's position in court will be that the federal backstop imposes an unconstitutional tax on Ontarians.²⁴ An independent legal opinion commissioned by the Government of Manitoba and released on October 11, 2017, concluded that the federal government does have the authority to implement the federal backstop and stated that there was a "strong likelihood that the Supreme Court of Canada would uphold the proposed carbon tax/levy."²⁵

Other provinces and prudent industry appear to be considering these developments very carefully, particularly Alberta's NDP government that will fight a 2019 election against the Unified Conservative Party (UCP) where energy pipelines and carbon pricing are anticipated to be central election issues. Specifically, UCP Leader Jason Kenney has vowed to repeal Alberta's long standing carbon

pricing system,²⁶ which was recently made more stringent through the Alberta *Climate Change Incentive Regulation (CCIR)*.

Legal issues abound in the midst of this carbon pricing policy whiplash, and responsible corporate entities and small energy customers appear to bear the greatest risks from the resulting uncertainties. Specifically:

- Responsible emitters have already invested \$2.8 billion in Ontario-auctioned emission allowances and now face the possibility that such investment could be stranded, absent a reasonable transition from the new Minister. Emitters with value at risk of being stranded are also likely to have enhanced pressures from their shareholders.
- Many responsible corporate entities have invested in emissions-reducing technologies and programs as a prudent business response to mandatory carbon pricing and the market value of surplus emission allowances and lower emissions resulting from such clean technology. Their institutional investors have embraced the Task Force on Climate-related Financial Disclosures²⁷ and are demanding greater transparency and information on climate strategy and management actions to facilitate a smooth business transition to a lower-carbon economy and take advantage of climate-related opportunities. Responsible management and boards of directors are therefore faced with contrasting government and stakeholder demands and are therefore likely to re-examine the changing business case and all related implications.

²⁰ See Bill C-74, *An Act to implement certain provisions of the budget tabled in Parliament on February 27, 2018 and other measures*, 1st Sess, 42nd Parl, 2018, (assented to 21 June 2018).

²¹ CBC Radio, "They don't have a climate plan": Catherine McKenna calls out new Ontario government", *CBC Radio* (19 July 2018), online: <<https://www.cbc.ca/radio/asithappens/as-it-happens-wednesday-edition-1.4751691/they-don-t-have-a-climate-plan-catherine-mckenna-calls-out-new-ontario-government-1.4751696>>.

²² Janyce McGregor, "Ontario joins Saskatchewan in opposing federal carbon tax plan", *CBC News* (19 July 2018), online: <<https://www.cbc.ca/news/politics/carbon-tax-premiers-thursday-1.4752747>>.

²³ Ministry of the Attorney General, Government of Ontario, News Release, "Ontario Announces Constitutional Challenge to Federal Government's Punishing Carbon Tax Scheme" (2 August 2018), online: <<https://news.ontario.ca/mag/en/2018/08/ontario-announces-constitutional-challenge-to-federal-governments-punishing-carbon-tax-scheme.html>>.

²⁴ *Ibid.*

²⁵ Government of Manitoba, News Release, "Province Releases Expert Legal Opinion on Carbon Pricing" (11 October 2017), online: <<https://news.gov.mb.ca/news/index.html?item=42320>>.

²⁶ Robson Fletcher, "Jason Kenney says he supports a carbon tax — but only on major industrial emitters in Alberta" *CBC News* (7 May 2018), online: <<https://www.cbc.ca/news/canada/calgary/ucp-kenney-carbon-tax-power-politics-large-emitters-1.4652145>>.

²⁷ See *Task Force on Climate Related Financial Disclosures*, online: <<https://www.fsb-tcfd.org/>>.

- Other registered participants in the Ontario cap and trade market, including offset companies and energy trading companies, have invested in primary allowances and secondary emission allowance instruments, which are also estimated to be of material, but now potentially stranded, value.
- Natural gas utilities and their customers are in the midst of at least two regulatory proceedings²⁸ before the Ontario Energy Board, wherein the cost and value of Ontario cap and trade compliance instruments, related renewable natural gas and geothermal programs, additional low carbon fuel standards (federal and provincial), and the final amounts charged to customers are at issue. All of the regulated gas utilities, natural gas consumer groups, and the regulator itself await further policy determinations in order to assess the potential impacts of repealing Ontario's CT System. Quebec has similar renewable natural gas proceedings pending before the Régie de l'énergie.²⁹
- Environmental groups, including the Canadian Environmental Law Association (CELA), have launched legal application for review of the repeal of Ontario's CT System to the Environmental Commissioner of Ontario on the basis of the Ford government's failure to provide the required notice and/or consultation on the repeal pursuant to section 67 of the *Environmental Bill of Rights, 1993*.³⁰
- California and Quebec emitters holding material quantities of Ontario allowances will prudently be required to consider what, if any, legal or other relief

is available to compensate them for the value of the potentially stranded Ontario allowances that they hold. California and Quebec regulators, CARB and Ministère du Développement durable, de l'Environnement et de la Lutte contre les changements climatiques (MDDELCC), respectively will similarly be required to prudently consider what legal or other relief, if any, they can obtain and/or should provide to affected entities. California has assessed that Ontario allowances represent less than 1 per cent of its current cap and trade market,³¹ however both jurisdictions will no doubt monitor their August 14, 2018, joint allowance auction to assess the impacts of Ontario's withdrawal from the WCI System.

- Provinces and other entities will also need to assess what role, if any, they will play in the Saskatchewan constitutional reference, and the legal, constitutional, and shareholder implications of any decisions not to participate.
- Ontario will also need to determine, what, if any, meaningful climate policy it will implement in lieu of the CT System and work with energy, environment, and financial regulators in attempt to effect a smooth transition.

In summary, governments and stakeholders are being called upon respond to an increasing number of *policy* issues and challenges that will result from the Ontario decision to repeal cap and trade on very tight timelines.

In addition, Ontario's repeal of the CT System presents a number of *political* challenges that the federal government and its climate policy allies³² will need to navigate in a very ambitious

²⁸ See EB-2017-0319, "Renewable Natural Gas Enabling and Geothermal Energy Service Programs", Enbridge Gas Distribution Inc., *Ontario Energy Board*, online: <<https://www.oeb.ca/participate/applications/current-major-applications/eb-2017-0319>> and EB-2017-0224, EB-2017-0255, EB-2017-0275, "Application for Approval to Recover the Costs Associated with 2018 Cap and Trade Compliance Plans", Enbridge Gas Distribution Inc., Union Gas Limited, EPCOR Natural Gas Limited Partnership, *Ontario Energy Board*, online: <<https://www.oeb.ca/participate/applications/current-major-applications/eb-2017-0224>>.

²⁹ See R-4008-2017, "Énergir - Demande concernant la mise en place de mesures relatives à l'achat et la vente de gaz naturel renouvelable", Société en commandite Gaz Métro, *Régie de l'énergie*, online: <http://publicsde.regie-energie.qc.ca/_layouts/publicsite/ProjectPhaseDetail.aspx?ProjectID=411&phase=1&Provenance=A&generate=true>.

³⁰ Canadian Environmental Law Association, *Application for Review re Ontario Regulation 386/18*, filed 18 July 2018, online: <https://www.cela.ca/sites/cela.ca/files/EBR-Application-for-Review_cap-and-trade.pdf>.

³¹ California Air Resources Board, Compliance Instrument Report, "Linked California and Quebec Cap-and-Trade Programs Carbon Market Compliance Instrument Report" (9 July 2018), online: <<https://www.arb.ca.gov/cc/ca-pandtrade/complianceinstrumentreport.xlsx>>.

³² These include, among others, New Zealand, Japan, Australia, and Norway.

Fall 2018 policy season and 2019 election year. The California Global Climate Action Summit and New York Climate week may necessitate nuanced Canadian policy developments leading into the negotiation of the United Nations Paris Rulebook at COP 24 in Katowice, Poland in December, 2018. But the real challenges for the federal government are likely to arise in and around elections. With Quebec going to the polls on October 1, 2018, Alberta on May 31, 2019, and the federal election on October 21, 2019, further extreme partisan positioning on carbon pricing may reasonably be anticipated over the next year. Soon after pipelines appear to have hit their zenith, carbon pricing may, in fact, be Canada's next existential energy crisis that requires concerted policy and political attention. ■