CANADIAN MANUFACTURERS & EXPORTERS SUBMISSION

Output-Based Pricing System (OBPS) Options for GHG Offsets Consultation

To:

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Introduction:

On behalf of Canadian Manufacturers & Exporters (CME) and our 2,500 direct members across the country, we are pleased to provide our comments on the Government of Canada's discussion paper, "Carbon Pollution Pricing: Options for a Federal GHG Offset System".

Manufacturing is the largest business sector in the country, directly accounting for 11 per cent of GDP, 66 per cent of exports, and 1.7 million employees in high wage, high skilled jobs in nearly every community across the country.

Manufacturing is also a critical driver of innovation, prosperity and jobs in Canada. Throughout its integrated operations and supply chains, the sector today directly and indirectly accounts for nearly 30 per cent of all economic activity and over 25 per cent of employment. Manufacturing also directly account for 35 per cent of all private-sector research and development, and 75 per cent of all exports.

Background:

CME believes that offsets can play an important role in cost-effectively achieving climate goals is significant. As part of an emissions trading solution, offsets can provide climate benefits in the least time which can reduce GHG emissions as efficiently as possible for the manufacturing sector. Including offsets in a climate change solution for manufacturers can provide a financial incentive that accelerates the adoption of GHG reduction activities in industries within manufacturing not covered under the compliance program (be it provincially or federally administered). These actions can result in real, measurable GHG

reductions, while helping to finance clean technology adoption and energy efficiency in the sector– democratizing climate action to a broader range of manufacturers.

Recommendations:

CME's high-level recommendations for the discussion paper can be summarized as follows:

1. Establish clear, stable rules and offsets framework to ensure market participation and confidence.
2. Support for market linkage and cross-border compatibility across carbon markets.
3. Minimize transaction costs to project development and credit creation for manufacturers.

Our recommendations are described in greater detail below.

Establish Clear, Stable Rules and an Offsets Framework:

CME supports any legislative and regulatory efforts to establish a clearly defined, predictable and transparent offsets framework over the long-term. In our view, a functioning offsets program expands market flexibility and forms a key component to a broader emissions trading system for the manufacturing sector. Clear, stable and predictable regulatory language and rules, upon which all manufacturing plants can base long-term business and investment decisions, is critical. Above all, regulators must avoid introducing uncertainty with unanticipated market design changes for manufacturers. Based on input from our members, unexpected offsets program design or protocol changes will have negative impacts on economic growth, investment, confidence, and our sectors ability to reduce their environmental footprint at least-cost to businesses and consumers. Establish clear, stable rules and offsets framework to ensure market participation and confidence.

Minimize Transaction Costs for Manufacturers:

The offset program should allow compliance units to be generated in as cost-effective a manner as possible. A meaningful offset system simply will not be possible, if transaction and development costs are too high and if opportunities to reduce GHG emissions for manufacturers become limited. To increase the number of market participants, trading protocols must be economically viable, verification and registry costs must be reasonable, and aggregated project/product development should be allowed. As demonstrated in existing carbon markets, high transaction costs can cause smaller offset projects to not be developed, and therefore limit supply and drive-up overall program and compliance costs. As part of the development of the offset system, CME believes that wherever possible that the Government of Canada use of conservative, data-driven default values in offset protocols and deployment of the most efficient current monitoring technologies and systems to help manage costs for manufacturers.

Increased Support for Market Linkage and Cross-Border Compatibility:

CME strongly encourages ECCC to encourage fungibility for manufacturers beyond provincial borders. The benefits of market linking and cross-provincial/border partnerships are clear: the bigger and broader the market, the wider the range of abatement opportunities, technology innovations, and improved efficiencies, resulting in a reduction in business costs, an expanded portfolio of emission reductions opportunities, new green jobs, more investment and technology adoption. It is critical that aligning rules, offset protocols, processes, infrastructure and other program elements across Canada and internationally is an important step towards building broad and effective low carbon markets for manufacturers. Cross-border alignment also allows companies, particularly those facing regulatory and trade-exposure across multiple jurisdictions, to more efficiently and cost-effectively plan and invest into their manufacturing plants.

In line with international law, the federal offset system should also be guided by the principle of achieving compatibility with Internationally Transferred Mitigation Outcomes (ITMOs) and cooperative approaches, as established under the 2015 international Paris Agreement. CME believes that the Government of Canada must ensure that its offset program has the highest standards and clear guidelines for accounting and environmental integrity. This is important in order to ensure that offsets can ultimately be transferable as recognized emissions reduction units – not only across provincial borders, but also across other international jurisdictions in conformance to Article 6 of the international UNFCCC Paris Agreement.

Conclusion:

CME appreciates the opportunity to record our comments on Canada's discussion paper, Carbon Pollution Pricing: Options for a Federal GHG Offset System. Our more detailed comments can be found attached to this submission. We would be pleased to discuss our submission with you at your convenience.

Detailed Comments:

Design System Considerations:

Overall, CME is supportive of the design considerations as outlined in the paper. More specifically, CME supports that the system will only issue offset credits that represent real, quantified, verified, additional and Unique GHG reductions. We also support the considerations that the system will be administratively simple and takes experience into account with consideration for the federal offset system to complement existing federal climate policies. That said, we want to urge the federal government to take steps to avoid double regulation, additional costs and minimal administration. CME recognizes that offsets generated under the federal system must come from reductions occurring in Canada, at least initially. However, we urge the Government of Canada to also enable the recognition of credible units generated under other systems, including other provincial systems and international programs that could be used for Output-Based Pricing System (OBPS) compliance purposes. Canada's offset system should also be guided by the principle of achieving compatibility with ITMOs and cooperative approaches, as established under the 2015 international Paris Agreement. We also encourage the Government of Canada to ensure that its offset program has the highest standards and clear guidelines for accounting and environmental integrity, in order to ensure that Canada's offsets can ultimately be transferable as recognized emissions reduction units – not only across provincial borders, but also eventually across other jurisdictions in conformance to Article 6 of the international UNFCCC Paris Agreement.

Alignment and Collaboration:

<u>CCME Offsets Framework Alignment:</u>

CME supports the federal government's intention to align with the Canadian Council of Ministers of Environment (CCME)'s Pan-Canadian Greenhouse Gas Offsets Framework. Aligning rules, offset protocols, processes, infrastructure and other program elements across jurisdictions within Canada and internationally is an important step towards building a sustainable offset system. Cross-border alignment also allows manufacturers, particularly those facing regulatory exposure and trade-exposure across multiple regions, to more efficiently and cost-effectively plan and invest.

<u>Collaboration with Provinces & Territories:</u>

The provincial offset systems in Canada should remain independent under the federal system and offer lessons learned and best practices to the federal government as the offset system design and implementation is carried out. The benefits of creating market linkages and cross-provincial/border partnerships are clear: the bigger and broader the market, the wider the range of carbon abatement opportunities, technology adoption opportunities, and increased productivity, resulting in a reduction in business costs and an expanded portfolio of emission reductions opportunities, more green jobs and increased investment.

Key Elements and Criteria for Project Eligibility:

CME has concerns about key elements and criteria listed in the paper. While we are encouraged to see the proposed criteria reflect the direction of CCME's collaborative approach to the Pan-Canadian GHG offset framework, priority should be given to adaptation of Protocols from existing jurisdictions that demonstrate a reduction of emissions at a point source as brought forth or sponsored by industry (e.g.. Carbon Capture and Storage or Waste Heat to Power rather than no-till or plant a forest protocols). In our view, protocols that incent reductions of combustion emissions above and beyond a company's compliance obligations should be honored. Moreover, inter-provincial offset trading should be allowed in which any offset that is registered in a Canadian jurisdiction should be honored by the Federal OBPS for compliance and all provincial protocols should be eligible as well.

Protocol Development and Considerations:

CME believes that only activities for which ECCC has approved a Federal Offsets Protocol may be eligible to generate offset credits. As such, we strongly feel that ECCC should review and accept current offset protocols from other jurisdictions. This will allow for quick, early adoption in the market – providing the needed supply of offsets, especially in the early years. Moreover, clear decision-making criteria and transparency on the decision-making process should be a key consideration. As such, we support the use of ISO 14080:2018 and international best practices for protocol adaptation to achieve this goal. We also support the protocol considerations outlined in the paper, including the use of ISO 14064-2, and the adherence to the following principles: relevance, completeness, consistency, accuracy, transparency and conservativeness and the need that the protocols address additionality, leakage, verifiability and permanence.

CME recommends the creation of Technical Advisory Teams to help develop Federal Offset Protocols. There is a knowledge and expertise across Canada in protocol development, including decades of experience in other provinces. To that end, CME encourages ECCC to leverage that experience and expertise as the protocols are developed. It is important to emphasize that it is crucial that protocol and project developers know the timeframes for protocol approval. As such, we believe outlining the protocol review process and expected timelines should be a priority action.

Project Registration and Aggregation

Project Registration:

CME is concerned with the proposed approach to project registration as outlined in the paper. Specifically, we are concerned with the proposal that, "*Only reductions that occurred after the federal offset system is in place will be eligible to generate Offset Credits*". This restriction is inconsistent with the proposed scope of the offset system which allows projects with a start date of 1 January 2017 or later. In ECCC's paper, Carbon Pricing: compliance options under the federal output-based pricing system, it was stated that an

offset credit would be eligible if the project start date is after the date that the Government of Canada published the Pan-Canadian Approach to Pricing Carbon Pollution (October 2016 or later). The registration approach currently proposed imposes an arbitrary restriction that penalizes early action and delineates the impact of the pricing signal to carbon markets. It is common practice in offset system design to allow for project eligibility after a signal was sent to the market (in this case, with the publication of the Pan-Canadian Approach to Pricing Carbon Pollution in October 2016). Market mechanisms are efficient because they send signals to the market that are factored into investment decisions. GHG reduction projects from eligible offset technologies that were undertaken since 2017 will have factored in that market signal and should not be punished for taking early action. Abandoning the value of the reductions achieved through these projects, by restricting project eligibility until after the federal offset system is in place, is an arbitrary restriction that discourages early movers. Furthermore, such arbitrary restrictions send the opposite signal to the market: that it should not undertake any proactive measures and wait until all regulatory and administrative matters are settled before considering action.

Aggregated Projects:

CME would like to learn additional details on ECCC's approach to registration of aggregated federal offset projects and encourages ECCC to consider CME's concerns outlined above with the current proposed approach to project registration. CME supports permitting aggregators in the federal offset system – and applauds ECCC's recognition of the important role that aggregators play. Aggregation is an effective way to bring value to smaller project proponents (such as single farms) who are reducing emissions and should be compensated for their efforts. Many successful project types, especially in forestry and agriculture, are not viable without aggregation. Aggregation is also very common in existing compliance offset markets and should be allowed in Canada's offset program.

Monitoring, Reporting and Crediting Periods

Monitoring & Reporting:

CME believes that reporting and surrender deadlines should be identical or as aligned/practical as possible for existing and future programs. This enables more alignment, drives efficiencies (both for administrators and manufacturers) and facilitates near or longer-term linkage across systems. To that end, we also support independent third-party verification of the report, recognizing the importance of transparency and verification in ensuring environmental integrity of the system.

Crediting Periods:

Pre-determined crediting periods are necessary to allow for investment confidence in offset projects – an 8-year crediting period appears reasonable. CME supports longer crediting periods for storage-based projects relative to non-storage-based projects. In our view, crediting period extensions should not be limited, but rather consider the additionality of projects at the time of extension request.

Verification and Validation

Verification:
CME believes that Verification should be a critical component of the Federal Offset System. Given this, CME encourages ECCC to require third-party verification for the federal offset system.

Validation:
CME believes that validation should not be mandatory. That said, it should be made available to project developers who choose the extra assurance.

Revocation, Replacement and Reversals

Liability & Ownership:
CME encourages an approach to ownership of least interference possible, meaning that ownership is established between the parties involved in project/product development. Project developers (aggregators included) should declare and prove ownership at project registration. In cases where an entity does not have clear ownership of the physical infrastructure (e.g., land, equipment) or intellectual property, all stakeholders should reach consensus on ownership and demonstrate their agreement in a legally enforceable contract.

Suspension, Revocation and Replacement:
To support fungibility and encourage broad participation in commercial transactions, CME supports an insurance-based approach to managing revocation and replacement risk for compliance credits. It is reasonable for the risk of revocation and replacement to be held by someone in the transaction chain to incent the appropriate scrutiny and assignment of accountability to protect against bad actors in the market. However, to provide credit purchasers and producers with some protection against unquantifiable cost to replace revoked credits, CME suggests that insurance-based policies for invalidation be adopted. In many instances, leakage or reversals are better assessed and managed at a protocol level. It can often be excessively burdensome and/or inaccurate to assess and manage at a system level. CME recommends establishing guidance in the relevant protocols for how to determine leakage. We support the proposed approach to suspension of a credit, prior to revocation if the Minister has reasonable grounds to believe that the project proponent did not conform to any and all regulations.

Reversal:
Penalties associated with intentionally causing a reversal should incorporate a payback ratio of 1:1. CME supports the establishments of Environmental Integrity Accounts (buffer accounts) to be used in cases of invalidation, so credit purchasers can be confident in the validity of credits purchased in good faith. Similarly, credit generators (project developers) can have a known, identifiable cost associated with

protection against revocation risk. The buffer account should be accessible to replace credits that are revoked due to issues outside the control of the issuing facility. CME supports the proposal to allow for the use of credits in the buffer account in place of suspension, revocation or replacement. In cases of fraud or negligence, including errors or omissions under the control of the issuing facility, responsibility for replacement must sit with the facility to encourage the appropriate due diligence ensuring all issued credits are done so with the utmost scrutiny and attention to detail.

Emissions Trading and Use Considerations:

CME strongly supports the allowance of market participants in the OBPS and Federal Offset System, and the reliance on supply and demand in the market to determine the value of offset credits.

Tracking System:

When considering enforcement and fungibility, there should be emphasis on an efficient system and registry, where there is no duplication of review processes. A structure similar to Alberta is encouraged, where the Registry reviews and approves serialization, and where the verifier and verification report provide the technical support for serialization and issuance. The structure in California is more prone to discourage fungibility, as there is a duplication of the review process which can cause long delays and uncertainty when issuing offsets that can lead to market inefficiencies. The system could be revised in future years based on a robust market analysis of supply and demand to correct for any market deficiencies.

Other Considerations:

Co-Benefits:

Underwritten by the carbon market, offsets can provide various non-climate environmental improvements for free. For example, offsets generated through fertilizer management can limit nutrient run-off; offsets generated through wetlands restoration can create waterfowl habitat and flood protection; offsets created through improved forest management, reforestation, and avoided degradation sustain robust ecosystems, potentially far into the future. It can also work to engage local communities in developing sustainable land-use practices that benefit their economic development. In such ways, offsets can help achieve important non-climate environmental objectives without additional cost. CME strongly supports ECCC's proposed intention to encourage such co-benefits.