September 1, 2009

Mr. Steve Borg
Project Manager
Ministry of the Environment
Integrated Environmental Policy Division
Air Policy Instruments and Programs Design Branch
135 St.Clair Avenue West, Floor 4
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**RE: Discussion Paper: Moving Forward - A Greenhouse Gas Cap-and-Trade System for Ontario, June 2009 (EBR #010-6740)**

Dear Mr. Borg:

Thank you for the opportunity to comment on the Ministry of the Environment Discussion Paper: Moving Forward: A Greenhouse Gas Cap-and-Trade System for Ontario, June 2009, which was posted for public comment on the Environmental Registry (EBR #010-6740). Conservation Ontario, representing Ontario's 36 Conservation Authorities, acknowledges the importance of the reduction in greenhouse gas emissions for sustainable growth, to combat climate change and to protect, maintain and restore the health of our watersheds. Conservation Authorities are very supportive of the proposal from the Ontario government to develop a greenhouse gas cap-and-trade program for the province.

The Ontario government's commitment to advancing work on the design of a greenhouse gas emissions trading system for Ontario to help meet the Province's climate change reduction goals and inform discussions on Ontario's participation in a broader trading program for North America, is applauded. Stakeholder comments are necessary to complement and inform the development of potential future regulations. To assist the Province in this effort, the following comments and suggestions are submitted for your consideration based upon the review by staff from Credit Valley Conservation, South Nation Conservation, and Toronto and Region Conservation Authority.

General Comments

The feedback from stakeholder consultations and comments in the December 2008 paper, along with information on developments in other jurisdictions planning cap-and-trade programs are presented very clearly. The development of a cap-and-trade system is supported, and such a policy is likely the most cost efficient way to reduce greenhouse gas emissions. The discussion paper makes numerous references to the need or desirability of harmonizing with other cap-and-trade and offset systems that are being developed. Since a unified continental cap-and-trade system will be essential to successfully achieving greenhouse gas reductions, the Province is encouraged to harmonize its system with the emerging Western Climate Initiative (WCI) system, as well as U.S. and Canadian federal systems that are presently being developed.

The Waxman-Markey Bill sets up a carbon trading system for the United States. The American system may indirectly dictate how other systems will look, given the importance of its influence on other markets. Alignment of Ontario's proposed system with the American system will avoid competitive prejudice to Ontario businesses. Also, duplication with the proposed federal emission trading regulations should be avoided, and Ontario's system will also align with the Western Climate Initiative (WCI).

Conservation Authorities(CAs) are key providers of outreach, technical support, training and compliance support on a range of watershed management and stewardship programs and legislative initiatives. CAs work with various stakeholders, including business emitters. CAs own significant amounts of land that may provide opportunities for afforestation and agriculture related offsets.

It is recommended that the cap-and-trade program be as simple as possible. This is based on experience of CAs and the work they do with private landowners and other stakeholders. Specifically, South Nation Conservation Authority (SNC) has had experience with water quality trading and what works best for the stakeholders it works with, most likely those who fall under the uncapped sectors in the proposed cap-and-trade system, such as agriculture and forestry. The likelihood of landowners or industries participating would decrease if they have difficulty calculating and selling their credits, particularly for carbon sequestration projects. The program that SNC implements, is a closed market system, where trades only occur through the Conservation Authority. This system is received well by the smaller emissions producers. All of the administrative work, such as offset calculations and reporting is completed by a third party; in this case, South Nation Conservation Authority, while the dischargers (emissions producers) only need to pay into the program and the landowners only need to implement their projects.

Also, the use of existing programs for delivery is recommended where possible. This will reduce the launch time for the trading program and will benefit from the relationships or partnerships formed through the existing programs. For the sequestration component, such as tree planting, there should be a standardized method of calculating the carbon offset that can be applied. Otherwise it is believed that if landowners were to calculate credits on their own, there will be fewer participants and greater inconsistencies across the province. For example, the South Nation Conservation Authority program uses scientific calculations that have been peer-reviewed and deemed defensible by the Ministry of the Environment. Also, program priorities should be set at the provincial level, and allow for local delivery, flexibility and adaptation of the program to local environments and communities. Promotion of emissions reductions and climate change education is highly effective when delivered at the local level..

Specific Comments

Comments and suggestions regarding the policy options found in Section *2.0 Policy Issues and Options*, as well as in Section *3.0 Discussion* of Moving Forward, have been inserted into the table below.

| Sub-section | Policy Options | Comments, Suggestions, and Recommendations |
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| **Section 2.2 Cap Setting and Allocation** | | |
| Allowance Distribution (Allocation) | **Electricity** – full auctioning immediately, or higher initial auctioning level to be increased over time to full auction? | Comment:<br>▪ It seems reasonable that the electricity sector should be required to obtain all of its allowances through auction, since there appears to be significant GHG reduction possibilities from this sector through the use of new technologies. |
| | **Vulnerable sectors** – gratis allocation initially, to be adjusted in step with major trading systems as they evolve?<br>**Process emissions** – gratis allocation to be considered and adjusted in step with major trading systems as they evolve? | Comment:<br>▪ It seems reasonable that trade exposed industries should be granted free allowances in the early years of the program, provided that these free allowance decline over time. This will allow these industries to slowly adjust to the new market conditions and remain competitive in the global marketplace. |
| | **Non-vulnerable sectors/facilities** – allocation based on historical emissions/baseline vs. benchmarking/output-based allocations of a hard cap? | Comment:<br>▪ It is suggested that allocations should not be based on historical emissions as this will provide benefits to the heaviest polluters.<br><br>Suggestion:<br>▪ Auctioning is supported for non-vulnerable sectors. |

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| | **Use of auction revenue** – to be used for what purposes:<br>- Only for reductions in regulated sectors (i.e. energy efficiency, technology support)?<br>- For reductions in uncapped sectors?<br>- For broader social, environmental and economic purposes (i.e. impacts on low-income households, climate change adaptation, economic efficiency)? | Comments:<br>▪ The use of auction revenue for promoting reductions from uncapped sectors, such as promoting emission reductions and sequestration in agriculture, forestry and other uncapped sources; and the support of community-wide efforts/ projects undertaken by local governments to reduce GHG emissions is supported.<br>▪ A portion of the auction revenue should be used for broader social, environmental and economic purposes.<br>▪ It seems reasonable that at least a portion of the revenue generated from auctioning the emission allowances should be devoted towards climate change mitigation efforts that will not generate offset credits.<br><br>Suggestions:<br>▪ Another option for the use of the funds is to assist the adaptation of human and natural communities to climate change.<br>▪ Funds from auction revenue could undoubtedly be used by CAs for many other purposes that would be difficult to fund otherwise, including projects related to adaptation to climate change.<br>▪ The auction revenue could also be used as a key revenue source for developing and carrying out a province wide payment for ecosystem services program.<br>▪ CAs can play a role in the facilitation of community adaptation to climate change.<br>▪ CAs are well positioned with staff and on the ground expertise to assist in implementing these potential approaches. |
| | **Reserve price** (i.e. floor) to deal with potential over-allocation of allowances:<br>*Yes – minimum reserve price to deal with over-allocations (as per WCI)?*<br>or<br>*No – don't use (as per Waxman-Markey)?* | Comments:<br>▪ Setting a price floor is essential if offsetting will be a component of a cap-and-trade system.<br>▪ Research quoted in the discussion paper shows that the allowance price under the Waxman-Markey proposal would increase 96 percent without international offsets. It was argued that this implies offsets are necessary to lower the cost of compliance. However, it could also be argued that this is evidence of offsets undermining the socially optimal allowance market price. The point of a cap-and-trade system is to internalize the external costs of pollution, sending clear market signals that lead to reduced emissions.<br>▪ Allowing offsets without a price floor could potentially lead to a suboptimal allowance price and a suboptimal level of emissions.<br><br>Suggestion:<br>▪ A price floor should be set (in combination with an offset limit) to maintain clear market incentive to reduce emissions. |

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| **Section 2.3 Credits for Early Action** | | |
| | | Comment:<br>▪ We feel it is important to provide incentive for early action. However, care should be taken when considering providing "credits" and its potential for undermining the initial cap through an influx of credits to the market (an issue alluded to in the Moving Forward document). The most logical and straight forward way to provide a clear incentive for early action is APPROPRIATE allowance allocation design. Auctioning is preferred as it provides the clearest and most simple message to industry – that being - early action means less costly compliance in the future. It also minimizes the administrative process and costs. Most importantly, auctioning eliminates the danger of an over allocation of credits. |
| **Section 2.4 Offsets** | | |
| Offsets | | Suggestion:<br>▪ CAs have the expertise and respect from the local un-capped industries and stakeholders to deliver an offset program. |
| Program Authority | A government agency?<br>or<br>An arms-length, public-private partnership? | Comments:<br>▪ A public-private partnership or arms-length agency is preferable to having government entirely responsible.<br>▪ A wide range of interests are required to cooperate in order for an offset system to work effectively, and it seems preferable that stakeholders should share the ownership and responsibility for administration of a project authority.<br>▪ The California Climate Action Reserve is very much in the nature of a public-private partnership and it appears to have developed into a credible and proactive organization.<br><br>Suggestion:<br>▪ CAs are also well positioned to take on some, if not all, of the role as Program Authority where especially relevant to the Agriculture and Forestry sectors. |
| Protocol Development | A protocol development role?<br>or<br>A protocol validation role? | Comment:<br>▪ Likewise, a hybrid approach to protocol development seems to be preferable, perhaps with some top-down priorities established.<br><br>Suggestion:<br>▪ Guidelines should be provided for project protocol developers. Protocols that have been developed for other systems could be reviewed as a basis for the development of protocols for an Ontario System.<br>▪ The role of protocol development or protocol validation should be a function of the Project Authority(ies), as is stated at the top of page 18 of the discussion paper.<br>▪ Therefore, it is recommended that the Program Authority with the Ontario government, lead protocol development and validation. The Program Authority could review protocol development work of other jurisdictions and perhaps selectively apply for observer status during the |

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| | | development of other offset systems. If desired, the Authority could adapt those protocols to its situation. |
| Project Types | Should the Ontario government initially support the WCI project types indicated by the experts including landfill gas, wastewater treatment, manure management, including anaerobic digestion, and afforestation/reforestation project types? | Comments:<br>▪ The discussion paper thoroughly discusses offsets, and the WCI priority offset project types (listed in footnote on page 19): soil sequestration; manure management; afforestation /reforestation; forest management; forest preservation /conservation; and urban forestry.<br>▪ All of the listed projects are consistent with activities undertaken by CAs; and therefore, the full spectrum of project types listed by the WCI are supported.<br>▪ Urban forest management can make a significant contribution to climate change mitigation in the urbanized watersheds typical of southern Ontario, and it would be beneficial for this project type to be recognized.<br><br>Suggestions and Recommendations:<br>▪ In addition to the project types listed in the discussion paper, it is recommended that wetland preservation/ conservation projects, as well as wetland restoration projects be considered as eligible offset projects. While wetlands are variable and the carbon and methane pathways are complex, they store a disproportionately high amount of carbon. Mitra, Wassmann and Vlek[1] cited estimates that wetlands occupy 4-6% of the earth's land area but store between 20 and 25% of the world's organic soil carbon.<br>▪ Management of industrial wastewater that results in GHG reductions should be considered, as offsets from waste management appear to be limited only to landfill gas recovery and municipal wastewater management plants. Wastewater is a waste resource, which could be used by another company to displace potable water or to extract heat prior to discharge to the sanitary sewer system.<br>▪ Waste-to-energy projects for GHG reductions should be considered as an approved offset category.<br>▪ The role of CAs as potential generators of offsets through afforestation and agriculture should be contemplated. CAs will be interested in leading research, facilitating local implementation of offset programs, and developing protocols to quantify carbon capture from riparian ecosystems, wetlands and other regeneration efforts, if required by the Province.<br>▪ Recognition of district energy as an offset generator requires further clarification.<br>▪ Offsets from transportation projects such as fuel switching or fuel conservation initiatives should be considered to encourage and promote sustainable transportation.<br><br>[1] Mitra, Wassmann and Vlek. 2005. An appraisal of global wetland area and its organic carbon stock. Current Science 88(1), 10 January 2005. |

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| Additionality | Which tests should Ontario use to assess the additionality of projects? Should Ontario recognize offset projects that have received incentive funding? | Comments:<br>**Additionality**<br>▪ Additonality is a key concept and the idea behind it is that credit should not be given for that which would have been done in the absence of carbon regulations and markets.<br>▪ The concept is very difficult to apply in practice. The paper asks for suggestions on determining additionality. A project would have to exceed regulatory requirements to be considered additional.<br>**Recognition of projects which have received incentive funding**<br>▪ It is recommended that the Province recognize offset projects that have received funding. Given that the sequestration projects (for example, tree planting) are usually initiated by a cost-share or subsidy, program uptake could be impacted if they are not eligible. Carbon is being sequestered through a number of incentive programs and stakeholders should be able to participate in cap-and-trade.<br>Suggestion:<br>▪ It is suggested that the program could perhaps be designed to take into account projects that have received incentive funding versus those that have not. |
| Addressing Reversals and Permanence | | Comment:<br>▪ In the discussion paper the experts recommended that it is not desirable to prescribe or otherwise limit the approaches that can be taken to insure against the risk of reversals. This is supported.<br><br>Suggestions:<br>▪ Potential options include applying a discounting or holdback mechanism, pooling projects, purchasing options, purchasing insurance, or there may be a system wide insurance facility set up. This is an area where there will be innovation and limiting the options is not desirable.<br>▪ To ensure projects are maintained, program could be set up as an annual payment or in increments depending on the length of the commitment landowners have made to maintain their projects.<br>▪ This is already being done through many CA programs. An annual performance incentive is paid to the landowner once an annual inspection has confirmed that the buffer is still in place.<br>▪ Again, there is a role for CAs to play in the delivery of these project types. |
| Offset Limits | The experts group suggests that limitations on creating or using offsets for compliance use would not be needed. Should Ontario limit the use of offsets? If so, how should this limit be defined? | Comments:<br>▪ While CAs have not been privy to the information that lead to this conclusion, logic suggests that limits to offsets should be in place.<br>▪ If the purpose of a cap-and-trade system is to reduce GHG, then allowing unlimited offsetting could lead to industries continuing to pollute at above optimal levels all based on the implicit assumption that the emissions have been permanently sequestered elsewhere. |

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| | | ▪ The discussion paper states that "it is unreasonable to say that permanence should be guaranteed in perpetuity" when discussing sink reversal risk. If we accept that permanence can not be guaranteed then we are exposing ourselves to significant risk which could possibly be minimized by placing a limit on offsetting.<br>▪ The WCI offset limit appears reasonable, although could be set lower than 49% to increase incentives for emission reductions. |
| Banking | Should pre-compliance offsets approved by the program authority be recognized and available through banking for use when Cap-and-Trade begins? | Comments:<br>The following should be considered when reviewing the option of banking offset credits prior to the compliance period.<br>▪ The experts group indicated very strong support for allowing offset credits from a pre-compliance period. While this does provide certainty to providers and purchasers on the trading value of offsets, it would reduce the effectiveness of the initial cap depending on the cap option chosen.<br>▪ If the cap is based on emission levels up to 2012 then allowing banking prior to 2012 might not make sense if the goal is to reduce emissions, as doing so would effectively raise the emissions cap. |

Thank you again for the opportunity to provide comments regarding the Ministry of the Environment's Moving Forward: A Greenhouse Gas Cap-and-Trade System for Ontario, June 2009. Conservation Ontario and Conservation Authorities look forward to working with the Province to ensure that proposed legislation and protocols are practical and align with the existing systems and initiatives. If you have any questions regarding these comments please contact myself at (905) 895-0716 ext. 224.

Yours truly,

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