



July 23, 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
Toronto, Ontario M4V 1P5

Re: EBR Registry Number 010-6467 - Environmental Protection Amendment Act, (Greenhouse Gas Emissions Trading) 2009
EBR Registry Number 010-6740 - Moving Forward: A Greenhouse Gas Cap-and-Trade System for Ontario

Dear Mr. Borg:

The Canadian Petroleum Products Institute respectfully submits its comments on the Ministry of Environment Bill 185 - GHG EPAA, as well as the "Moving Forward" White Paper.

CPPI wants to recognize the Ministry of Environment's commitment to the bedrock principle of competitiveness for Ontario industry and certainly refiners. The Ministry has acknowledged that there needs to be alignment with the dominant North American system along with equivalency at the Canadian Federal level. Competitiveness benchmarking will continue to be an important element of this Policy.

CPPI Members have maintained and demonstrated a long standing commitment to improving environmental performance in Ontario. CPPI supports the Government's desire to regulate Greenhouse Gas Emissions (GHG's), however we believe that there are considerable opportunities to improve your goals and at the same time allow Canada's refining industry to continue to serve Ontarians.

CPPI recommends that the following fundamental design issues be taken into consideration to promote Policy success:

- 1) The petroleum refining sector in Ontario is vulnerable. Policies impacting our competitiveness in the North American framework can compromise the viability of Ontario refining operations.

- 2) Alignment with other jurisdictions is imperative. Boutique solutions will unnecessarily burden Ontarians and distort markets.
 - CPPI prefers a cohesive and aligned approach with the dominant North American system (equivalency with Canadian Federal regime).
- 3) If/when the transportation sector is included in the Policy then nothing short of a coordinated and comprehensive approach addressing reductions in the carbon intensity of fuel, increases in vehicle fuel efficiency, and decreased kilometers traveled is required.
- 4) Monies raised through auctioning of allowances should be focused on reducing distortionary taxes on income and capital.
- 5) We urge the Ministry to prioritize and appropriately sequence the multiple Policies impacting the refining sector. Overlapping GHG and environmental Policies draw heavily on human and financial capital in the industry.

Our detailed comments are in the attached appendices. Continued engagement with CPPI on this file is appreciated and we reserve the right to provide additional input.

Sincerely,



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Priority Issues Raised in “Moving Forward”

A Cap-and-Trade System for Ontario

1) ALIGNMENT WITH OTHER JURISDICTIONS IS IMPERATIVE:

(Refer to Section 2.1 in Moving Forward Document)

- Our recommendation is that the content and application of the Ontario Policy be cohesive and aligned with Canadian and eventually North American jurisdictions.
- Preservation of the long term Ontario refining industry competitiveness is critical and can only be achieved with a North American GHG Policy compatible framework. Similar Policy timelines and thresholds avoid market distortions.

2) A BOUTIQUE (REGIONAL) SOLUTION MAY BURDEN ONTARIANS:

(Refer to Section 2.0 in Moving Forward Document)

- Industry competitiveness will be severely impacted by cost burdens not borne by market participants in other jurisdictions. A unified carbon price approach can reduce carbon costs by a substantial amount versus a fragmented approach. The 2009 National Roundtable on the Economy and the Environment (NRTEE) study suggests that costs can be reduced by 50% under a unified approach.
- There is an emerging consensus that the ability to utilize a significant percentage of international offsets can also reduce prices by up to 50% (2009 NTREE report) while making a real contribution to GHG reductions.
- The transportation, commercial and institutional sectors are responsible for more than 63MT/year of GHG emissions in Ontario out of a total of approximately 200+ MT/yr. Significant additional costs would be imposed on the Ontario emitting companies whether the price is \$50 or \$300 per tonne.
- The future price of carbon is of course an unknown at this time. As such, design of Ontario's rules must take into account the following:
 - The price of carbon will be influenced by many elements; for example the environmental objectives set for industry, the availability of allowances and offsets and the geography of the trading area. An overly constrained or poorly designed ETS may lead to an inadequate supply of allowances to meet the market demand or could cloud the overall supply/demand position in the market.

- To avoid outcomes leading to significant price excursions in the allowance or levels of volatility that are not akin to good market performance, the following design and implementation features should be recognised:
 - a) Ontario needs to be careful in setting the right environmental target: the more severe the limits, the higher the cost will be.
 - b) The availability of allowances and offsets: domestic and international offset units should be recognised as instruments of compliance and should not be limited.
 - c) The ability to have banking of allowances into future trading periods and borrowing within a trading period will help smooth any price volatility.
 - d) The broader geography area of the ETS, the greater the liquidity of the allowances to be traded will be.
 - e) Getting this wrong will surely result in negative unintended consequences and will be difficult to correct in a timely manner.

3) **PETROLEUM REFINING IS A VULNERABLE SECTOR:**

(Refer to Section 2.1 'Sector Impacts' in Moving Forward Document)

- The Ministry indicates that the effects are expected to be most pronounced in sectors that are both energy-intensive and exposed to significant international trade, such as steel, cement and chemicals.
- Petroleum refining is a vulnerable sector.
 - Ontario imports approximately 35% of its transportation fuels annually and relies on international market forces. In addition to a strong north/south trade flow, product imports from Europe have a strong influence on Eastern Canada supply. A boutique solution breaks normal fuels flow and distorts markets.
 - Interprovincial trade could also be impacted given that imports from Quebec into Ontario account for approximately 20% of its supply (included in 35% noted above). Again CPPI prefers a National Climate Change Policy approach.
 - Refiners undertake 'make or buy' decisions on a daily basis. Policies which severely impact refining competitiveness would move the industry into "vulnerability status" and can compromise the viability of Ontario refining operations.
 - Capital initiatives in the petroleum refining sector in Ontario are evaluated relative to the attractiveness of other national and international projects. The uncertainty of the unknown cost curves and Policy outcomes could affect long term decisions over funding future investments in the Province.

4) **ALLOCATION PRINCIPLES AND METHODOLOGIES:**

(Refer to Section 2.2 in Moving Forward Document)

- CPPI believes that alignment between Canadian and American approaches to allocation both within and between sectors may be advisable. Specifically, CPPI does not want to be disadvantaged versus competitors or other sectors.
- CPPI has determined that refining in Canada is trade exposed..
- Free allocation for trade exposed sectors such as ours should be informed by the treatment in economically linked jurisdictions.
- In the short to medium term, CPPI can support a percent of free allowances transitioning to full auctioning as it pertains to alignment with other jurisdictions.
- If Ontario proceeds with a model that allocates allowances on the basis of production, CPPI would prefer a methodology that recognizes refining complexity instead of simple crude throughput.

5) **CONSIDERATIONS CAPS AND BASELINES:**

(Refer to Section 2.2 in Moving Forward Document)

- Canadian refineries have an excellent record in achieving emissions reductions at their facilities, having achieved an average improvement in efficiency of 1% per year over the past years despite an increasingly heavy crude slate and a series of other environmental programs which have forced them to install energy-intensive measures to reduce non-GHG emissions. While it is expected that these efficiency improvements will continue into the future, they are limited by the pace at which the relevant technology progresses.
- The petroleum refining industry is one of the few industries where both the emissions resulting from the production and the use of our products are subject to climate change regulation. Reductions in demand for refined petroleum products could challenge Ontario refineries to sustain even the current level of efficiencies. Moreover, our sector is regulated to modify fuel composition to reduce air pollutant emissions and the resultant additional processing via hydrotreatment to lower the sulphur content in fuels is a vivid example of this double edged obligation. In both areas, the ability to reduce emissions significantly depends on the development and deployment of new technology, much of which is beyond the control of the industry.
- Our industry generates process emissions. Process emissions are greenhouse gas emissions other than “combustion emissions“ occurring as a result of intentional and unintentional reactions between substances or their transformation, including the chemical or electrolytic reduction of metal ores, the thermal decomposition of substances, and the formation of substances for use as product or feedstock. For refineries, they specifically include hydrogen production installations and catalytic regeneration (from catalytic cracking and other catalytic processes). By definition, our industry has no means of reducing process

emissions, requiring even deeper cuts to combustion emissions. Should other jurisdictions provide free allowances to cover process emissions, or otherwise reduce the burden of reducing process emissions, Ontario refineries should be accommodated in the same manner.

- Policymakers should take these factors into account in setting both caps and baselines.
- CPPPI supports the following specific principles with respect to CAPS and BASELINES:
 - Must be rational and achievable.
 - Must have credibility on the international stage.
 - If flexibility options are not available then the slope of the target must be back end loaded.
- CPPPI does not support setting of baselines and caps using forecasts – this is not compatible with our investment horizon and the pace of technological breakthroughs.

6) **INDUSTRY TRANSITION – TECHNOLOGY FORCING POLICIES AND HOW REFINERS COMPLY:**

(Refer to Section 2.6 in Moving Forward Document)

- Our industry is dealing with a high pace of environmental regulatory change: air pollutants, GHG Policies, low carbon fuel standard, renewable fuel standards, toxic reductions, land - brownfields, water reclamation and use and waste as such, it draws heavily on financial and human capital. Prioritization of the regulatory path forward by the Ministry will guide decision making and investments. The Ministry should be mindful of this in setting emission caps.
- There are currently no magic bullets for GHG emissions reduction in the petroleum refining sector. The industry has been steadily taking actions particularly with respect to energy efficiency improvements, to reduce energy use and thus emissions. A 1% annual improvement in energy intensity has been realized by the refining industry in Canada for more than a decade. The trading system should be stand-alone and not be bolstered with additional mandated requirements, such as best available technology economically achievable (BATEA), for existing or new sources so to avoid two different price signals in the system.

7) **TECHNOLOGY FUND:**

(Refer to Section 2.6 in Moving Forward Document)

Policies to encourage the efficient use of energy and the longer term identification and deployment of break-through technologies will be critical as jurisdictions grapple with twin goals of addressing climate change and protecting economies. Our ability to predict the pace and ultimate cost of these developments is limited and so Policymakers are considering mechanisms to contain costs to "acceptable" levels. The Federal Government is considering including a Technology Fund approach in a cap and trade regulation to moderate compliance costs while helping fund the investments to transition to a low-carbon economy. Considerations for Ontario include:

- Would a Technology Fund be linked to a broader North American trading system?
- Would a Technology Fund allow Ontario to meet equivalency criteria of a US cap and trade system? Would it meet the equivalency of a broader cap and trade system such as the EU ETS?
- If the Canadian Federal Government proceeds with a Technology Fund as a compliance option would Ontario choose to not allow its emitters this option?
- Would Ontario consider compliance via a Technology Fund to be equivalent to realizing actual and current GHG emissions reductions?
- What would be the mechanism for generating monies for a Technology Fund if Ontario doesn't recognize contributions to the Technology Fund as a compliance option?
- How would the monies collected via a Technology Fund be allocated to effectively allow markets to incent the development of advanced technologies?

8) **THRESHOLDS:**

(Refer to Section 2.1 in Moving Forward Document)

- CPPI would prefer a model that truly ensured a level playing field for broad industry as well as within industry sectors. All entities that meet the 25kt threshold should be covered by this framework.

9) **PROTOCOLS FOR OFFSETS:**

(Refer to Section 2.4 in Moving Forward Document)

- CPPI supports one national/international cohesive approach, however:
 - Ontario should work with the Federal Government to ensure that any offset regime maximizes Canadian access to domestic and international options for compliance as a mechanism to moderate cost. Unlimited banking of allowances and offsets should be allowed.

10) **DESIGN REVIEW PROCESS (Industry Transition):**

(Refer to Section 2.6 in Moving Forward Document)

- Investment in energy infrastructure is a long-term undertaking. Whilst the market does not need the exact reduction target for every year far out into the future, it does need sufficient information on which to assess supply-demand and make some assessment of long-term carbon prices. In considering establishing a formal review period or trigger mechanisms for review, Ontario might take into account.
- What mechanisms for review have been established in other jurisdictions?
- How does Ontario want to address the potential impacts of deferral of long-term investment and innovation if businesses focus on short-term compliance?
- Can Policymakers find the right balance in setting credible and sustainable targets that are not too stringent nor too easy?

11) **COGEN ISSUES:**

One opportunity for further exploitation is that of cogeneration. Government Policy should be mindful to recognize the efficiency of producing both heat and power in this manner. The viability of these types of projects will be facilitated through allowance allocations or setting an equitable rate for electricity generated. Cogens are not “peaking” power, continuous steam production is essential to refiners. Ontario Policy needs to ensure that like the proposed Federal regime, there should be no disincentive to building and running Cogens.

Overarching Consensus Principles

Guiding Principles on Climate Change:

The climate change issue presents an immense and complex challenge not only for Ontario but globally. Policies to combat climate change will require a careful balancing of conflicting objectives and, if they are to be successful, an unprecedented level of inter-jurisdictional cooperation will be required. While the move to a lower carbon economy will offer economic opportunities, most analysts agree that the net cost to the economy will be significant.

Challenging but achievable real reductions without severe economy wide unintended consequences ought to be the goal.

CPPI believes that successful climate change Policies need to be based on a set of sound principles. The issue is so complex that few, if any, of the following principles can be absolute. At the same time, none of them should be ignored. Policymakers need to make a conscious effort to recognize, justify and mitigate the negative consequences of violating these principles.

CPPI recommends the following principles to achieve responsible progress in the area of climate change.

1) EQUITY:

- International Policies on climate change should not unfairly put one country at a disadvantage with respect to another.
- Canada's national Policy on climate change should not impose an unreasonable burden on a particular sector or Province.

2) COMMERCIAL SOLUTIONS:

- A free market is always the most efficient means of managing an economy, including energy supply and demand.
- Policies should therefore ensure that Canada's economy is open to world markets and remains competitive.

3) CONSISTENT GOALS:

- Policies on climate change should be consistent with the national priorities reflecting major economic and social goals (e.g. economic growth, trade, competitiveness, job creation, quality of life).

4) **COMPREHENSIVE OVERVIEW, FLEXIBILITY, COST-EFFECTIVENESS AND LIFECYCLE ANALYSIS:**

- Policies should foster a comprehensive overview, flexibility and cost-effectiveness.
- A comprehensive overview means one that encompasses all greenhouse gases, every region and sector, as well as all the options, which includes not only reduction, but also adaptation and confinement.
- Flexibility means measures that take into consideration the specific circumstances of a country, sector or region allowing the use of economic instruments when available.
- Cost-effectiveness means taking measures when the cost can be justified. The most effective measures are those that cost the least, have the greatest impact, produce the best return on investment and are easy to manage.
- Options must be assessed on the basis of a complete analysis of the lifecycle “from well to tires.”

5) **TRANSPARENCY:**

- The public must be informed about the social and economic impacts and repercussions of Policies before they are implemented.

6) **PROVEN SCIENTIFIC PRINCIPLES AND RISK MANAGEMENT:**

- Policies must be based on proven scientific and economic principles, risk assessment and a justification of costs.
- *CPPI further recommends that the Ontario Government undertake analysis of Bill 185 utilizing a lens of “Cap & Trade as an Economic Instrument for Climate Change”. **As such, the additional Guiding Principles below are important and worthy of full discussion/analysis:***

1) **COMPETITIVENESS OF THE REFINING SECTOR:**

- This is best met by alignment with a continental framework.

2) **CLIMATE CHANGE FRAMEWORKS:**

- C & T should lead to real GHG reductions.
- The framework needs to account for issues related to wealth transfer, economic growth and “carbon leakage”.¹ Full analysis of economic and social Policy tradeoffs.
- The aim of any Cap and Trade framework should be to achieve GHG reductions at the least cost.

¹ Carbon leakage occurs when there is an increase in carbon dioxide emissions in one country as a result of an emissions reduction by a second country with a strict climate Policy.

3) **FULLY INFORMED PUBLIC**

4) **ONE NATIONAL EFFORT, NO DUPLICATION OF BURDEN**

5) **FOR TRANSPORTATION SECTOR:**

- Transparency and equity are important recognizing the full well to wheel impact. (Fuel manufacturers, vehicle manufacturers and the public).
- It is important that the various Policies implemented to reduce GHG emissions in the transportation sector be coordinated with the goal of fostering cooperation among stakeholders rather than competition between them.