

ENFORCEMENT AND WITHDRAWAL UNDER THE CALIFORNIA-QUEBEC (AND NOT ONTARIO) CAP-AND-TRADE LINKAGE AGREEMENT

David V. Wright

A Symposium on
Environment in the Courtroom:
Enforcing Canadian GHG Emissions Laws

October 25 and 26, 2018
Université Laval



UNIVERSITÉ
LAVAL

Faculté de droit
Chaire de recherche du Canada
en droit de l'environnement



UNIVERSITY OF CALGARY
FACULTY OF LAW



Canadian Institute of Resources Law
Institut canadien du droit des ressources

This project was undertaken with the financial support of:
Ce projet a été réalisé avec l'appui financier de :



Environment and
Climate Change Canada

Environnement et
Changement climatique Canada

The Canadian Institute of Resources Law encourages the availability, dissemination and exchange of public information. You may copy, distribute, display, download and otherwise freely deal with this work on the following considerations:

- (1) You must acknowledge the source of this work
- (2) You may not modify this work, and
- (3) You must not make commercial use of this work without the prior written permission of the Institute.

Copyright © 2018

Enforcement and Withdrawal under the California-Quebec (and not Ontario) Cap-and-Trade Linkage Agreement

David V. Wright *

Introduction

Federal governments in Canada and the United States continue to face challenges in developing and implementing nation-wide carbon pricing mechanisms. In this context, sub-national initiatives continue to define much of climate law and policy in North America, with the California-Quebec-Ontario linkage breaking transnational ground in recent years.¹ Such an approach, however, remains highly experimental in nature.²

Two dimensions of critical importance to the efficacy of any emissions trading regime, are enforcement and withdrawal. The California-Quebec-Ontario linkage provides an opportunity to observe these dimensions in action. Ontario's recent withdrawal, for better or worse, marks a particularly timely opportunity to consider the formal withdrawal process under the linkage, as well as collateral legal implications.

Part I of this paper provides a short overview of the California-Quebec-Ontario linkage, including its origins in the Western Climate Initiative (WCI) and evolution into a functioning multi-jurisdiction emissions trading regime. Part II focuses on enforcement under the linkage, discussing the reciprocal nature of the arrangement and the enforcement regime in each jurisdiction. For completeness, Ontario is included in that discussion, notwithstanding recent events. Part III provides a short overview of the linkage withdrawal mechanism before then moving on to identify some of the legal implications flowing from Ontario's withdrawal. Finally, the conclusion provides reflections on this sub-national-led North American regime and future directions.

Part I - Overview of the California-Quebec-Ontario Linkage Agreement

Cooperation between Canadian provinces and U.S. states on greenhouse gas (ghg) emissions reductions has been taking place for more than a decade.³ For example, at its peak the Regional

* Assistant Professor, Faculty of Law, University of Calgary.

¹ See Quebec, Ministère du Développement durable, de l'Environnement et de la Lutte Contre les changements climatiques, *The Québec-California Carbon Market and Membership of Ontario in 2018*, online: <<http://www.mddelcc.gouv.qc.ca/changements/carbone/documents-spede/linking-qc-ca-ont.pdf>> (“world’s only carbon market designed, developed and operated exclusively by subnational governments in different countries” at 1).

² Note that many consider sub-national efforts to be a “second-best” option, believing a comprehensive federal regime – either cap-and-trade or carbon tax – to be preferable. See e.g. Cary Coglianese & Jocelyn D’Ambrosio, “Policymaking Under Pressure: The Perils of Incremental Responses to Climate Change” (2008) 40 Conn L Rev 1413; Valentina Bosetti & David G., “Victor, Politics and Economics of Second-Best Regulation of Greenhouse Gases: The Importance of Regulatory Credibility” (2011) 32:1 Energy J 1; Matthew Ranson & Robert Stavins, “Linkage of Greenhouse Gas Emissions Trading Systems: Learning from Experience” (2013) Harvard Kennedy School Faculty Research Working Paper Series ES 13-2; Ann Carlson, “Designing Effective Climate Policy: Cap-and-Trade and Complementary Policies” (2012) 49:2 Harv J on Legis 207.

³ For example, the New England Governors and Eastern Canadian Premiers forum adopted a “Climate Change Action Plan” in 2001. See Atlantic Conference of Premiers, “New England Governors and Eastern Canadian Premiers’ Annual Conference”, online: <www.cap-cpma.ca/about/new-england-governors-and-eastern-canadian-premiers-annual-conference-negecp/> (Listing the 2001 climate change plan as one of the groups’ specific accomplishments).

Greenhouse Gas Initiative included 9 states as participants and 6 provinces as observers in anticipation of eventually linking cap-and-trade markets.⁴ Meanwhile, in 2008 the U.S. west coast states and the province of British Columbia entered into the Pacific Coast Collaborative Agreement (PCCA),⁵ and adopted the Pacific Coast Action Plan on Climate and Energy in 2013.⁶ The latter included stated intentions of linking programs,⁷ though no carbon markets have linked under this umbrella to date.

The longest-running state-province collaboration, and most relevant for the purposes of this paper, is the Western Climate Initiative (WCI). The WCI began in 2007 as an agreement across several western U.S. states but expanded in subsequent years to include the Canadian provinces of British Columbia, Manitoba, Ontario, and Quebec.⁸ These eleven jurisdictions collectively produced the 2008 “Design Recommendations for the WCI Regional Cap and Trade Program”⁹ and the 2010 “Design for the WCI Regional Program”.¹⁰ The objective was to then put in place an inter-jurisdictional market-based program to reach agreed upon emission reduction targets.¹¹ As is observable today, most WCI members did not follow through to the point of implementing linked cap-and-trade systems under the agreed upon timeline.¹² The exceptions, of course, are Quebec and California, and for a brief period, Ontario. With much fanfare,¹³ these jurisdictions carried the collaboration through to a fully operational multi-jurisdiction, cross-border cap-and-trade system. California and Quebec signed a linkage agreement in September 2013, with the linkage becoming formally operational on January 1, 2014. In September 2017, Ontario entered into the Linkage Agreement, and on January 1, 2018 Ontario formally joined the market (though the provincial cap and trade market had been functioning since January 2017), only to withdraw in June 2018, soon after a change of government following the provincial election.¹⁴ In May 2018, the three parties held the fifteenth

⁴ See Regional Greenhouse Gas Initiative, “Program Design Archive”, online: < www.rggi.org>. Once RGGI became fully operational, it stopped using observer status as a term or designation. Instead, today any interested person, state, or other stakeholder is able to attend a meeting or provide comment, without need for a designated status. There are currently no provinces formally participating in RGGI

⁵ Pacific Coast Collaborative, “Memorandum to Establish the Pacific Coast Collaborative” (30 June 2008), online: <https://pacificcoastcollaborative.org/wp-content/uploads/2018/09/Memorandum-PCC_2008.pdf>.

⁶ Pacific Coast Collaborative, “Pacific Coast Action Plan on Climate and Energy” (28 October 2013), online: <<https://pacificcoastcollaborative.org/wp-content/uploads/2018/09/Pacific-Coast-Climate-Action-Plan.pdf>>.

⁷ *Ibid.*

⁸ See Western Climate Initiative, “History”, online: <<http://www.westernclimateinitiative.org/history>>.

⁹ Western Climate Initiative, “Design Recommendations for the WCI Regional Cap-and-Trade Program” (23 September 2008), online: < <http://www.mddelcc.gouv.qc.ca/changements/carbone/documents-WCI/modele-recommande-WCI-en.pdf>> [WCI Design Recommendations].

¹⁰ Western Climate Initiative, “Design for the WCI Regional Program” (27 July 2010), online: <http://www.westernclimateinitiative.org/the-wci-cap-and-trade-program/program-design> [WCI Regional Program Design].

¹¹ See *ibid.*

¹² *Ibid.*

¹³ See Ministère du Développement durable, de l’Environnement et de la Lutte Contre les changements climatiques, “Québec-California-Ontario Carbon Market: A strong Example of North American Collaboration”, *Cision News Wire* (28 February 2018), online: <<https://www.newswire.ca/news-releases/quebec-california-ontario-carbon-market-a-strong-example-of-north-american-collaboration-675459933.html>>.

¹⁴ The Linkage Agreement was updated to include Ontario in September 2017; however, it is now back to a two-party agreement.

joint cap-and-trade auction,¹⁵ and in August 2018, Quebec and California held the sixteenth joint auction, that one without Ontario.¹⁶

At the core of the linkage is the formal agreement: *Agreement between the California Air Resources Board and the Gouvernement du Québec Concerning the Harmonization and Integration of Cap-and-Trade Programs for Reducing Greenhouse Gas Emissions* (“Linkage Agreement” or “Agreement”).¹⁷ The Linkage Agreement was updated when Ontario joined.¹⁸ The Agreement codifies the collaborative arrangements between the parties through 23 Articles spread across three chapters: General Provisions, Harmonization and Integration Process, and Operation of the Agreement.¹⁹ The agreement sets the rules in areas such as consultation, regulatory harmonization, recognition and trade of compliance instruments, joint auctions, supervision and enforcement, administrative and technical support, confidentiality, withdrawal, amendments, resolution of differences, and coming into force.²⁰

However, while the Agreement is the centerpiece of the integrated cap-and-trade markets, it represents just one piece in a broader framework. This system is reciprocal in nature and is comprised of statutes, regulations and guidance put in place by each jurisdiction. For example, California’s legal context is underpinned by the 2006 *Global Warming Solutions Act* (typically and hereinafter referred to as “AB 32”), which empowered the California Air Resources Board (CARB) to “adopt a regulation that establishes a system of market-based declining annual aggregate emission limits for sources or categories of sources that emit greenhouse gas emissions” and to “consult with other governments to facilitate the development of integrated and cost-effective regional, national and international greenhouse gas reduction programs”.²¹ The California regime is fleshed out further through the *Air Resources Board Regulation for the Mandatory Reporting of Greenhouse Gas Emissions*²² and the *Air Resources Board Cap-and-Trade Regulation*.²³ Notably for the present discussion regarding enforcement, the California

¹⁵ Quebec, Ministère du Développement durable, de l’Environnement et de la Lutte Contre les changements climatiques, *California Cap-and-Trade Program, and Québec Cap-and-Trade System May 2018 Joint Auction #15: Summary Results Report*, online: <<http://www.mddelcc.gouv.qc.ca/changements/carbone/ventes-encheres/2018-05-15/resultats-vente20180515-en.pdf>>.

¹⁶ Quebec, Ministère du Développement durable, de l’Environnement et de la Lutte Contre les changements climatiques, *California Cap-and-Trade Program, and Québec Cap-and-Trade System August 2018 Joint Auction #16: Summary Results Report*, online: <<http://www.mddelcc.gouv.qc.ca/changements/carbone/ventes-encheres/2018-08-14/resultats20180814-en.pdf>>.

¹⁷ *Agreement between the California Air Resources Board and the Gouvernement du Québec Concerning the Harmonization and Integration of Cap-and-Trade Programs for Reducing Greenhouse Gas Emissions*, (27 September 2013), online: <http://www.arb.ca.gov/cc/capandtrade/linkage/ca_quebec_linking_agreement_english.pdf> [Linkage Agreement 2013].

¹⁸ *Agreement on the Harmonization and Integration of Cap-and-Trade Programs for Reducing Greenhouse Gas Emissions Between The Gouvernement du Québec, The Government of California and The Government of Ontario*, (22 September 2017), online: <<http://www.premier-ministre.gouv.qc.ca/entente-liaison-marche-du-carbone-en.pdf>> (All references throughout are to this updated Agreement unless otherwise specified) [Linkage Agreement 2017].

¹⁹ *Ibid.*

²⁰ *Ibid.*

²¹ *Global Warming Solutions Act of 2006*, AB 32 (2006) at § 38564.

²² CCR tit 17, §§ 95100-95158 (2015).

²³ CCR tit 17, §§ 95800 to 96023 (2013).

context is also shaped by SB 1018,²⁴ which, as discussed in Part II below, requires the Governor to make specific findings (including in relation to enforcement) prior to CARB taking action to approve the linkage.²⁵ In 2017, the California legislature passed AB 398 extending the state's cap-and-trade program to 2030 (there was an initial horizon of 2020).²⁶ AB 398 also includes measures, such as a price ceiling, to protect against extreme market fluctuations.²⁷

For Quebec's part, in 2009 the province passed Bill 42, *Act to amend the Environment Quality Act and other legislative provisions in relation to climate*,²⁸ which, similar to California, granted the Quebec Government powers to enact regulations that create a cap-and-trade system and to enter into an agreement with another government for the harmonization and integration of cap-and-trade systems.²⁹ The regime is structured and implemented through regulations, namely: the *Regulation respecting mandatory reporting of certain emissions of contaminants into the atmosphere*,³⁰ and *Regulation respecting a cap-and-trade system for greenhouse gas emission allowances*.³¹ As well, ghg emissions caps in line with Quebec's 2020 ghg emissions reduction goal are set through *Order in Council 1185-2012 Determination of annual caps on greenhouse gas emission units relating to the cap-and-trade system for greenhouse gas emission allowances for the 2013-2020 period*.³²

Legislative steps toward Ontario's linking began in 2009 with the passing of the *Environmental Protection Amendment Act (Greenhouse Gas Emissions Trading), 2009*.³³ That Act provided the government broad authority to implement a cap-and-trade system and established associated rules.³⁴ Similar to California and Quebec enabling statutes, the Act contemplated integration with other cap-and-trade regimes. This statutory basis was eventually updated with more detail and explicit authorities through the *Climate Change Mitigation and Low Carbon Economy Act*,³⁵ which was passed in February 2016. The regime was further fleshed out by the *Cap and Trade Program Regulation*³⁶ and the *Quantification, Reporting and Verification of Greenhouse Gas Emissions*,³⁷ both of which took effect on January 01, 2017. Ontario also put in place the *Guideline for the Quantification, Reporting and Verification of*

²⁴ CGC § 12894(f) (West 2013) [SB 1018].

²⁵ *Ibid.*

²⁶ US, AB 398, *California Global Warming Solutions Act of 2006: market-based compliance mechanisms: fire prevention fees: sales and use tax manufacturing exemption*, 2017-18, Reg Sess, Cal, 2017.

²⁷ See Rahul Rana et al, "An Impact Analysis of AB398 on California's Cap-and-Trade Market", online: (2017) California Carbon <http://californiacarbon.info/wp-content/uploads/2017/07/AB398-_Impact_Analysis.pdf>.

²⁸ Bill 42, *Act to amend the Environment Quality Act and other legislative provisions in relation to climate*, 1st Sess, 39th Leg, Quebec, 2009.

²⁹ *Environment Quality Act*, RSQ 2015, c Q-2, s 46.14 (It was pursuant to this provision that the Linkage Agreement was entered into) [EQA].

³⁰ RRQ 2018, c Q-2, r 15.

³¹ RRQ 2018, c Q-2, r 46.1 [Cap-and-trade Regulation].

³² OC 1185-2012, (2012) GOQ II 3612.

³³ Bill 185, *An Act to amend the Environmental Protection Act with respect to greenhouse gas emissions trading and other economic and financial instruments and market-based approaches*, 1st Sess, 39th Leg, Ontario, 2009.

³⁴ *Ibid* at s 176.1.

³⁵ SO 2016, c 7 [CCMLCEA].

³⁶ O Reg 144/16.

³⁷ O Reg 143/16.

Greenhouse Gas Emissions.³⁸ As will be discussed in the final part of this paper, following the June 2018 provincial election, the new Ontario government cancelled the cap-and-trade program, including the revocation of these regulations and repeal of the *Climate Change Mitigation and Low Carbon Economy Act*.

Part II - Enforcement Under the Linkage Agreement

The linkage is premised on an approach of reciprocity and harmonization within a context that acknowledges each jurisdiction's sovereignty in the administration of respective programs.³⁹ Such architecture began through cooperation under the WCI. For example, the WCI *Design Recommendations for the WCI Regional Cap-and-Trade Program*⁴⁰ recommended that "[E]ach WCI Partner jurisdiction will retain and/or enhance its regulatory and enforcement authority and responsibilities to enforce compliance with the cap-and-trade program within its own jurisdiction".⁴¹ Similarly, the *Design for the WCI Regional Program* document, which provided a roadmap for WCI partner jurisdictions developing respective implementing regulations, stated that each jurisdiction "will use its authority to enforce compliance with the WCI Cap-and-Trade program within its own jurisdiction".⁴² It went on to explain that harmonization and compliance verification are essential to ensure consistent outcomes and a level playing field, but acknowledged that "the degree of harmonization is subject to each WCI Partner jurisdiction's legislative and administrative processes and acknowledges that each jurisdiction maintains sovereignty in the administration of its program".

This approach was explicitly included in the 2014 Quebec-California Linkage Agreement,⁴³ and was carried into the updated 2017 Ontario-Quebec-California Linkage Agreement⁴⁴ (the latter included some slightly updated language but did not substantively alter enforcement and withdrawal aspects).

Article 11 sets out the supervision and enforcement regime:

The Parties shall work cooperatively to maintain market integrity, including preventing fraud, abuse and market manipulation and to ensure the reliability of the joint auction and their respective programs. The Parties shall work cooperatively in applying their respective program requirements governing the supervision of all transactions carried out among registered participants of each of the Parties and of any auction or reserve sale.

The Parties shall facilitate, in accordance with the privacy, and other statutes and regulations applicable in each of their jurisdictions and the provisions of article 15 hereunder, the sharing of information to support the effective administration and enforcement of each party's statutes and regulations.

³⁸ Ontario, Ministry of the Environment and Climate Change, *Guideline for Quantification, Reporting and Verification of Greenhouse Gas Emissions*, online:

<http://www.downloads.ene.gov.on.ca/envision/env_reg/er/documents/2017/013-1457_d_Guide.pdf>.

³⁹ *Supra* note 11, WCI Regional Program Design at 24.

⁴⁰ *Supra* note 10, WCI Design Recommendations.

⁴¹ *Ibid* at article 12.1.

⁴² *Supra* note 11, WCI Regional Program Design at 24.

⁴³ *Supra* note 18, Linkage Agreement 2013.

⁴⁴ *Supra* note 19, Linkage Agreement 2017.

This exists within the broader context of harmonization required under Article 4:

The Parties shall continue to examine their respective regulations for the reporting of greenhouse gas emissions and for the cap-and-trade program in order to promote continued harmonization and integration of the Parties' programs.

In the case where a difference between certain elements of the Parties' programs is identified, the Parties shall determine if such elements need to be harmonized for the proper functioning and integration of the programs...

A Party may consider making changes to its respective programs, including changes or additions to its emissions reporting regulation, cap-and-trade program regulations, and program related operating procedures. To support the objective of harmonization and integration of the programs, any proposed changes or additions to those programs shall be discussed between the Parties...⁴⁵

These rules for harmonization and cooperation in enforcement under the linkage are supported by further requirements with respect to robust offset protocols,⁴⁶ compliance instruments,⁴⁷ trade,⁴⁸ and accounting mechanisms.⁴⁹ In practice, compliance and enforcement - and trading - depend on the "Compliance Instrument Tracking System Service" (CITSS), which is the registry of compliance instruments for the entire cap-and-trade program. It acts as a management and tracking system for accounts and compliance instruments issued through the cap-and-trade linkage, allowing market participants to hold and retire compliance instruments and to trade compliance instruments with other account holders. In short, CITSS is the market hub that facilitates the flow tradable allowances.

Under this approach of reciprocity and respect for sovereignty, which may be the product of constitutional constraints on cross-border activities of sub-national governments,⁵⁰ the respective state or provincial enforcement regimes of each Party are of primary importance. California legislators recognized this in the lead-up to entering into the initial linkage with Quebec. As a safeguard, they passed SB 1018, which required the Governor to confirm that the program to be linked has environmental and enforcement requirements that are "equivalent to or stricter than" the California program, that California be able to enforce its laws to constitutional limits, and that there be no "significant liability" imposed on California for any "failure associated with linking to the Quebec program or related participation in in WCI, Inc".⁵¹ Such a

⁴⁵ *Ibid* at art 4.

⁴⁶ *Ibid* at art 5.

⁴⁷ *Ibid* at art 6.

⁴⁸ *Ibid* at art 7.

⁴⁹ *Ibid* at art 8.

⁵⁰ See David Wright, "Cross-border constraints on climate change agreements: legal risks in the California-Quebec cap-and-trade linkage" (2016) 46:6 10478.

⁵¹ See United States, California, Department of Justice, *Memorandum of Attorney General's Advice to the Governor Concerning Linkage of California and Quebec Cap-and-Trade Programs*, (5 March 2015), online: <https://www.gov.ca.gov/docs/AG_Letter_SB_1018.pdf>.

review and confirmation by the Governor's office was indeed completed ahead of California's linking with Quebec,⁵² and then again prior to Ontario joining.⁵³

California

California's enforcement regime flows from the statute and regulations referenced above. Specifically, the regulation expressly includes prohibitions on any trading involving a manipulative device, a cornering of or an attempt to corner the market, fraud, attempted fraud, or false or inaccurate reports.⁵⁴ Under the regulations, violations of the regulations can result in civil or criminal penalties,⁵⁵ and perjury statutes apply.⁵⁶ Administratively, the California program includes mechanisms to monitor and prevent market manipulation.⁵⁷

Institutionally, it is CARB that leads enforcement. CARB has authority to issue orders to covered entities and to set and issue penalties for violations. For example, under the cap-and-trade regulations, if a covered entity misses an annual or triennial obligation deadline, then it must submit emission allowances equal to four times the entity's excess emissions.⁵⁸ Beyond that, if the entity does not submit allowances of excess emission after 30 days, then CARB may issue a \$25,000 fine per missing allowance per 45 days.⁵⁹ Additionally, CARB has authority to suspend, revoke, or restrict holding accounts for covered entities.⁶⁰

Quebec

Quebec's enforcement regime flows from the statute and regulations referenced above. Several enforcement tools exist, including administrative monetary penalties (AMPs), quasi-criminal offences (and associated penalties), and several other specific measures such as suspension, withdrawal or cancellation of emissions allowance. These powers are administered by the Ministère du Développement durable, Environnement et de la Lutte contre les changements climatique (MDDELCC).

With respect to AMPs and regulatory offences, the *Environment Quality Act* provides a general framework for applying administrative sanctions in connection with penal proceedings. Specific penalties and applicable AMPs are set out in the cap-and-trade regulation, which contains several financial and legal penalties of varying degrees depending on the infraction and severity of transgressions at issue.⁶¹ The regulation provides for penalties of \$500-\$500,000 and

⁵² United States, California, Office of the Governor, *Governor Brown letter of April 8, 2013*, online: <https://www.gov.ca.gov/wp-content/uploads/2017/09/Request_for_SB_1018_Findings.pdf>; See also United States, California, Office of the Governor, *SB 1018 Request for Cap-and-Trade Program Equivalency Findings*, (26 February 2013), online: <<https://www.gov.ca.gov/2013/02/26/news17933/>>.

⁵³ United States, California, Office of the Governor, *Governor Brown letter of March 16, 2017*, online: <https://www.arb.ca.gov/cc/capandtrade/linkage/response_to_sb_1018_request.pdf>.

⁵⁴ *Supra* note 25, SB 1018 at § 95921(f)(2).

⁵⁵ *Ibid* at § 96013.

⁵⁶ See e.g. *ibid* at § 95832 (Designation of Representatives and Agents) and § 95914 (c)(3) (Auction Participation and Limitations).

⁵⁷ See California Air Resources Board, *Regulatory Guidance Document*, (6 November 2017), online: <<https://www.arb.ca.gov/cc/capandtrade/guidance/guidance.htm>>.

⁵⁸ *Supra* note 25, SB 1018 at § 95857(b).

⁵⁹ *Ibid* at § 96014.

⁶⁰ *Ibid* at § 95921(g)(3).

⁶¹ *Supra* note 32, *Cap-and-trade Regulation* at ss 71-75.5.

up to 18-months of imprisonment for an individual, or \$10,000-\$3 million in the case of non-compliance for a corporation.⁶² Additionally, financial penalties double in the case of a second offence.

In some circumstances the Minister may suspend, withdraw, or cancel any allowance for certain violations.⁶³ The Minister may also refuse to register an emitter for an auction or sale if the emitter provides false or misleading information, omits required information, or contravenes a rule of procedure.⁶⁴ In some cases, such as providing false or misleading information, transgressors risk being guilty of an offence as well as being barred from the market.⁶⁵

With respect to meeting emission reduction requirements under the cap, if an emitter does not have sufficient allowances by 01 November of the year following the end of a compliance period (i.e. in 2015, 2018 and 2021), then the entity's account will be suspended along with a requirement to pay a penalty of three emissions allowances for each missing allowances.⁶⁶ If after the 30 days the emitter cannot produce required allowances, the Minister will subtract the owed allowances from the emitter's next free allowance allocation.⁶⁷

Ontario

Enforcement under Ontario's regime was primarily set out in the legislation referenced above, though, compared to Quebec and California, Ontario had more specifics at the statute level. Similar to Quebec, enforcement in Ontario featured financial and legal penalties of varying degrees depending on the infraction and severity of transgression at issue. Under the *Climate Change Mitigation and Low-carbon Economy Act, 2016*, individuals convicted of an offence could be liable for fines of \$5,000 - \$6 million and imprisonment for up to a year.⁶⁸ Corporations could be liable for fines of \$25,000 - \$10 million.⁶⁹ Once again, such penalties enforced specific prohibitions in relation to trade such as fraud and market manipulation or providing misleading or untrue information.⁷⁰ These also applied with respect to prohibitions on disclosure⁷¹ and obstructing administration of the Act.⁷²

In terms of non-compliance with emission reductions obligations under the cap, the *Climate Change Mitigation and Low-carbon Economy Act, 2016* imposed a penalty similar to Quebec. If a market participant failed to submit all required allowances by the deadline, the Act required additional emission allowances in an amount equal to three times the shortfall⁷³ and provided authority to issue fines and impose other consequences.⁷⁴

⁶² *Ibid.*

⁶³ See e.g. *ibid* s 47 (suspension of emissions allowance allocation); See also s 46.2.

⁶⁴ See e.g. *ibid* ss 47 (auction), 60 (sale); See also *supra* note 30, *EQA* at s 46.12.

⁶⁵ See e.g. *supra* note 32, *Cap-and-trade Regulation* at ss 75.2 and 60 (operating in tandem).

⁶⁶ *Ibid* at s 22.

⁶⁷ *Ibid.*

⁶⁸ *Supra* note 36, *CCMLCEA* at s 51 (1) and (5).

⁶⁹ *Ibid* at s 51(2) and (4).

⁷⁰ *Ibid* at s 29.

⁷¹ *Ibid* at s 32(6) and (7).

⁷² *Ibid* at s 64.

⁷³ *Ibid* at s 14(7).

⁷⁴ *Ibid* at s 14(8).

Ontario's enforcement regime also included AMPs by way of the *Administrative Penalties Regulation*,⁷⁵ which provides a list of contraventions to which the penalties apply, including failure to follow provisions regarding the trading of emission allowances or credits, coordinating bidding, or perpetuating fraud contrary to the Act; failure to quantify and report the amount of greenhouse gas emitted, or to use the appropriate quantification methodology, contrary to the *Quantification, Reporting and Verification of Greenhouse Gas Regulation*; failure to register as a mandatory participant within the time prescribed under the *Cap and Trade Program Regulation*; and failing to provide a reversal report, or an accredited verification body failing to provide a verification report, as required pursuant to the *Ontario Offset Credits Regulation*. The AMP regime was underpinned by s.57 of the CCMLE, which provided general authority for AMPs to be imposed for the purposes of ensuring compliance with the Act and to prevent any participant from deriving an economic benefit from contravening the Act.⁷⁶

These respective enforcement regimes function in parallel across the entire linkage to ensure that market actors comply with all applicable rules and face significant penalties for failing to do so. Regular compliance reports are made publicly available by CARB and MDDELCC.⁷⁷

Part III - Ontario Withdrawal from the Linkage

As a “first order of business” following the June 2018 provincial election,⁷⁸ the newly elected Premier pulled Ontario out of the linkage by revoking the cap and trade regulations and suspending all trading on July 3, 2018. Such withdrawal is explicitly contemplated under the Linkage Agreement. Article 17 states:

A Party may withdraw from this Agreement by giving written notice of intent to withdraw to the other Parties. A Party that intends to withdraw from this Agreement shall endeavour to give 12 months notice of intent to withdraw to the other Parties. A Party that intends to withdraw from this Agreement shall endeavor to match the effective date of withdrawal with the end of a compliance period.

Notably, Article 17 provides some clarity to California and Quebec as the Parties remaining in the linkage:

If a Party withdraws, the Agreement shall remain in force for the remaining Parties.

While this process of withdrawal is prescribed in relatively clear terms in the Linkage Agreement, at the present time it is not clear that Ontario followed the process. To date, it seems that Ontario has not published documentation of its “written notice of intent to withdraw” pursuant to Article 17. It is possible that such has been provided to California and Quebec; however, no such documentation has surfaced in the public domain. Further, it is abundantly clear

⁷⁵ O Reg 540/17.

⁷⁶ *Supra* note 36, CCMLE at s 57.

⁷⁷ See e.g. MDDELCC, “Linked California and Québec Cap-and-Trade Programs Carbon Market Compliance Instrument Report - Aggregated by Type and Account” (5 October 2018), online: http://www.mddelcc.gouv.qc.ca/changements/carbone/ventes-encheres/Rapport_soldes/20181005-rapport-soldes-en.pdf.

⁷⁸ Amara McLaughlin, “Doug Ford vows to scrap Ontario's cap-and-trade program as his 1st act as premier”, *CBC* (15 June 2018), online: <<https://www.cbc.ca/news/canada/toronto/doug-ford-cap-and-trade-1.4707728>>.

that Ontario did not “endeavour to give 12 months notice of intent to withdraw to the other Parties”, nor did it “endeavor to match the effective date of withdrawal with the end of a compliance period”. Rather, the withdrawal was done without formal notice at all, other than statements made by the new Premier soon after the election and an apparent declining by Ontario to participate in the sixteenth joint auction.

To date, the clearest discussion of Ontario’s withdrawal is from California. CARB issued the following update in September 2018:

On July 3, 2018, the Ontario government published a regulation (386/18) revoking Ontario’s cap-and-trade regulation (144/16), and suspended all Ontario entity CITSS accounts. With Ontario’s departure from the linked carbon market, California and Québec are working together to ensure that the environmental integrity and stringency of our cap-and-trade program and market is maintained. Our goals are to make certain that the program continues to reduce emissions of climate-changing gases as a crucial part of our efforts to combat the existential threat of climate change, while also continuing the smooth operation and integrity of our joint carbon market.

Please note that all compliance instruments in accounts registered in California or Québec are valid for compliance purposes and for trading or selling between participants of the two jurisdictions.⁷⁹

This suggests that California acknowledges Ontario’s formal withdrawal under the Linkage Agreement, notwithstanding the seeming lack of formal notice under the Article 17. It may well be the case that California’s interest in success of the linkage and efficacy of the Linkage Agreement has resulted in it not wanting to draw attention to the fact that Ontario did not follow the terms of the Agreement.

Meanwhile, Ontario’s withdrawal includes legal steps beyond the process set out in the Linkage Agreement. On July 3, 2018, the new Ontario Government filed Ontario Regulation 386/18 (Regulation), which prohibits participants in the cap and trade scheme from purchasing, selling, trading or otherwise dealing with emission allowances and credits.⁸⁰ On July 25, 2018, the new Ontario Government introduced *Bill 4: Cap and Trade Cancellation Act* to formally wind down the Ontario cap and trade program. The Act repeals Ontario Cap and Trade legislation⁸¹ provides for the “retiring” or “cancelling” of cap and trade instruments (including those created under the Quebec or California systems), the payment of compensation by the government to a select few types of market participants (approx. 250 capped Participants total), and the barring of any legal recourse against the government.⁸² The Act does require Ontario to

⁷⁹ California Air Resources Board, *Linkage* (7 September 2018), online: <<https://www.arb.ca.gov/cc/capandtrade/linkage/linkage.htm>>.

⁸⁰ O Reg 386/16.

⁸¹ Specifically, it repeals the *Climate Change Mitigation and Low-carbon Economy Act, 2016*.

⁸² See Richard Corley et al, “Ontario Introduces Bill To Cancel Cap And Trade And Launches Carbon Tax Case”, online: (2018) Goodmans LLP <<http://www.mondaq.com/canada/x/726816/Clean+Air+Pollution/Ontario+Introduces+Bill+To+Cancel+Cap+And+Trade+And+Launches+Carbon+Tax+Case>> (For a summary).

establish ghg reduction targets and to prepare a climate change plan,⁸³ which will likely be in line with the new Premier's challenge to the federal backstop carbon price.⁸⁴

In the wake of this relatively sudden and fundamental change in Ontario, it is unclear what value emission credits now hold. As summarized by commentary from the private bar, “businesses holding some \$2.8 billion in allowances have no market to offload their purchases, and it is unclear what legal remedies are available to these parties or whether refunds are forthcoming”.⁸⁵ To date, Ontario's move has generated more legal questions than answers for former market participants. It would be reasonable to expect that the Ontario Government will be sued by emitters and non-governmental organizations; however, the outcomes (and, to some degree, causes of action) are hard to predict. One of the first suits out of the gate was a case brought by Ecojustice on behalf of several environmental groups. It alleges that the Ford government unlawfully failed to provide for public consultation on both the Regulation and on the *Bill 4: Cap and Trade Cancellation Act*, as required by the Ontario *Environmental Bill of Rights*.⁸⁶ The lawsuit also challenges the validity of the Regulation on that basis that it is inconsistent with, and fundamentally undermines, the purpose of the *Climate Change Mitigation and Low-Carbon Economy Act 2016* pursuant to which it was filed.⁸⁷

Conclusion

While this sub-national linkage across the Canada-U.S. border demonstrates that much can be accomplished in the absence of federal leadership, it also reveals a fundamental weaknesses. The respective enforcement regimes of California, Quebec and, formerly, Ontario are comprehensive, robust, and, with various tools and penalties available, relatively nuanced. High compliance rates (and, therefore, significant emission reductions) suggest that the respective and harmonized enforcement regimes have been effective at encouraging good market behaviour and deterring delinquency. However, the recent experience with Ontario's withdrawal reveals a fundamental weakness in the system: easy withdrawal with minimal consequences. Notwithstanding the carefully designed and implemented architecture of the linkage in most regards, this readily available low-resistance path to leaving the market undermines overall market integrity and subverting the otherwise strong enforcement regime.

⁸³ Bill 4, *An Act respecting the preparation of a climate change plan, providing for the wind down of the cap and trade program and repealing the Climate Change Mitigation and Low-carbon Economy Act, 2016*, 1st Sess, 42nd Leg, Ontario, s 4(1).

⁸⁴ Robert Benzie, “Ontario Tories launch constitutional challenge against federal Liberal carbon-pricing measure”, *The Toronto Star* (2 August 2018), online: <<https://www.thestar.com/news/queenspark/2018/08/02/ontario-tories-launch-constitutional-challenge-against-federal-liberal-carbon-pricing-measure.html>>.

⁸⁵ Thomas Timmins et al, “From Cap-and-Trade to White Pines: What Lies Ahead in Ontario's Energy Sector”, online: (2018) Gowling WLG <<http://www.mondaq.com/canada/x/720162/Energy+Law/From+CapandTrade+to+White+Pines+What+lies+ahead+in+Ontarios+energy+sector>>.

⁸⁶ See Ecojustice, “Challenging Ontario's gutting of cap and trade program”, online: <<https://www.ecojustice.ca/case/challenging-ontarios-gutting-of-cap-and-trade-program/>>; See also *GreenPeacace Canada v Minister of the Environment, Conservation and Parks and Lieutenant Governor in Council*, Notice of Application for Judicial Review, online: <<https://www.ecojustice.ca/wp-content/uploads/2018/09/Notice-of-Application-issued.pdf>>.

⁸⁷ *Ibid.*

As the design and implementation of multi-jurisdictional carbon markets evolves, parties and regulated entities would be wise to build in stronger withdrawal mechanisms that augment the enforcement regimes by increasing the difficulty of a jurisdiction departing, thus providing more market certainty and reliability for all actors involved. Unfortunately, there may be political barriers to doing so, given that a stronger locking in of a jurisdiction's commitment to link may deter linking in the first place. Additionally, legal barriers such as constitutional dimensions continue to constrain how far states and provinces can go with entering international agreements that contain binding obligations.⁸⁸

Ultimately, the foregoing examination of the linkage's enforcement and withdrawal dimensions demonstrates the limitations of a sub-national led approach. While state-province collaboration has provided important momentum and action leading to ghg emission reductions, thanks in part to effective enforcement regimes, there is no substitute for federal leadership and coordination. This does not mean that linkages between nation-states would not also be susceptible to parties withdrawing, but the ability for nation-states to enter into binding agreements would better safeguard against sudden, disruptive withdrawal, and would also lend itself to strong enforcement regimes. In the meantime, however, carbon markets worldwide will continue to benefit from lessons learned through the ambitious and laudable actions of sub-national actors.

⁸⁸ *Supra* note 50.