

Summary of Québec’s Regulation Respecting a Cap-and-Trade System for Greenhouse Gas Emission Allowance

On 14 December 2011, the Government of Québec approved its “[Regulation respecting a cap-and-trade system for greenhouse gas emission allowances](#)” after a public consultation. Québec’s rules were finalized one day after California approved its [final rules](#), setting the stage to potentially link the two programs for a 2013 start date. This document provides a detailed summary of Québec’s regulations.

Background

Québec has a greenhouse gas (GHG) emissions reduction target of 20% below 1990 levels by 2020. As part of the Western Climate Initiative, the province developed a cap-and-trade program, releasing its first draft rules in July 2011 for public comment, and finalizing the regulation on 14 December 2011. For Québec, finalizing provincial cap-and-trade rules was the first part of its WCI obligation – the second part is linking their program to other WCI members like California.

Key Changes from Draft Rules

Before delving into a summary of the complete regulation details, this brief outlines key changes made to the draft rules in the final version released 14 December. The few changes made appear to facilitate linking with California. Further details on these aspects will be provided later in the document.

Table 1: Key Changes from Draft to Final Rules

Auction Floor Price	Draft: Starting at \$15/tonne, increasing 7% per year Change: Starting at \$10/tonne, increasing 5% per year (plus inflation)
Allowance Reserve Price	Draft: Fixed price between \$40-50/tonne Change: Starts between \$40-50/tonne and increases 5% per year (plus inflation)
Allowance Allocation	Change: Select importers of electricity may now be eligible to receive free allowances in final regulations ¹
Holding Limits	Change: Introduction of holding limits in final regulations

¹ Significant conditions apply – see section on Allocation below for more details



Scope and Coverage

Québec's cap-and-trade program will regulate emissions from carbon dioxide (CO₂), and six other greenhouse gases (GHGs): methane (CH₄); nitrous oxide (N₂O); hydrofluorocarbons (HFCs); perfluorocarbons (PFCs); sulphur hexafluoride (SF₆); and nitrogen trifluoride (NF₃).

The following sectors are covered by the cap and trade regulations:

Table 2: Sectors covered by the regulations

Sector	Notes
Mining, Quarrying, and Oil and Natural Gas Extraction	Extraction of naturally occurring minerals
Electric Power Generation, Transmission and Distribution	Generation of bulk electric power, transmission from generating facilities to distribution centres, and/or distribution to end users
Natural Gas Distribution	Distribution of natural or synthetic gas to the ultimate consumers through a system of mains. Gas marketers or brokers, that arrange the sale of natural gas over distribution systems operated by others, are included
Steam and Air-Conditioning Supply	Production and/or distribution of steam and heated or cooled air
Manufacturing	Physical or chemical transformation of materials or substances into new products
Pipeline Transportation of Natural Gas	Pipeline transportation of natural gas, from gas fields or processing plants to local distribution systems

There are several exclusions from the regulation:

- CO₂ from biomass combustion or fermentation is not included;
- CH₄ from coal storage is not included;
- CO₂, CH₄, and N₂O emitted from mobile equipment on the site of an establishment are not included
- *Until 2015*, CH₄ from operations of a petroleum refinery is not included;
- *Until 2015*, CH₄ and N₂O from anaerobic wastewater treatment, petroleum refineries, pulp and paper mills, and production of petrochemical products are not included;
- *Until 2015*, CO₂, CH₄, and N₂O emissions from transportation and distribution of natural gas are not included.

Aviation and shipping fuel is not subjected to the rules.



Annual Cap and Allowance Budgets:

Soon after the final rules, Québec released its annual cap figures. The initial cap for the first compliance period starting in 2013 will be 23.7Mt, dropping to 23.3Mt in 2014. The cap will rise for the start of the second compliance period in 2015 to 63.3Mt due to the expansion of program scope. The cap decreases out to 2020 where it will be set at 50.9Mt. Throughout the whole program life, the cap decreases on average 4% per year.

Table 3: Annual Allowance Budgets 2013-2020

Compliance Period	Year	Allowances (Mt)
First	2013	23.7
	2014	23.3
Second	2015	63.6
	2016	61.0
	2017	58.5
Third	2018	56.0
	2019	53.4
	2020	50.9

Administration

The Minister of Sustainable Development, Environment and Parks will keep four accounts to house emissions units:

- An *allocation account*, which contains the emissions units to be distributed without charge to qualifying emitters;
- An *auction account*, which contains emission units to be sold at auction;
- A *reserve account*, which contains reserve emission units that can be distributed by sale or used to adjust the quantity of emission units allocated without charge; and
- A *retirement account*, where emission units are retired from the system after they have been used for compliance.

Registration

Emitters

Every emitter covered by this regulation starting in the first compliance period must register for the system between 1 May and 1 September 2012 (details below on which specific sectors are covered in the first compliance period). Emitters starting compliance in the second period must register between 1 May 2012 and 1 September 2014.



Any further emitters in a covered sector that reach or exceed the threshold of 25Kt CO₂e in a given year must register by 1 September of the following year.²

Non-Emitters

Non-emitting entities may also register for the system as a participant if they are interested in purchasing and trading emission allowances. These participants may register on or after 1 May 2012.³

Disclosure of Business-Relationships

All emitters or participants that register must disclose any “business relationships” they have with other registered emitters or participants. In this case, a “business relationship” means any direct or indirect relationship between several different emitters or participants when one of them:

- a) holds more than 20% of the securities of another emitter or participant or holds a call provision or call option for such securities;
 - b) shares more than 20% of the securities of another emitter or participant or holds a call provision or call option for such securities;
 - c) holds more than 20% voting rights in another emitter or participant;
 - d) controls over 20% of the business of another emitter or participant by any means;
- or*
- e) belongs to the same group as another emitter or participant (eg. one is a subsidiary of another).⁴

Account Details

Once an entity is registered, it will be given two accounts by the Minister. One is a *general account* where emissions units are held that can be banked and traded.

The other is a *compliance account* where an entity must hold its allowances for compliance at the end of a compliance period. Allowances in a compliance account must stay in that account and may not be traded.

Compliance

The cap and trade program runs from 2013 to 2020, with options for continuation beyond (required emissions reporting begins in 2012). There are three scheduled compliance

² For required registration documentation, see Section 7 of the [regulations](#)

³ For required registration documentation for non-emitting participants, see Section 8 of the [regulations](#)

⁴ For more details on business-relationships, see Section 9 of the [regulations](#)



periods: the first will cover 2013-2014; the second from 2015-2017; and the third from 2018-2020.

During the first compliance period, the cap will cover industrial and electricity sectors, alone. Facilities in these sectors whose annual emissions from 2009, 2010, or 2011 were at or over the threshold of 25Kt CO₂e will be subject to the rules. The Québec government expects that approximately 75 facilities will qualify under this first compliance period.

Beginning in the second compliance period in 2015, the scope of the cap will extend to cover entities that distribute fuel in Québec or import fuel for their own consumption (all sectors listed in Table 2 above), who have emitted 25Kt CO₂e or more in 2012 or 2013.⁵ Transport emissions – Québec's largest emissions source – will be covered beginning in this second compliance period.

Any emitter in a covered sector that subsequently reports an annual emissions total at or over the 25Kt CO₂e threshold will have to begin compliance the following year.

Emitters must comply no later than 1 October of the year following the end of the compliance period, and must do so by containing enough allowances in their compliance account to cover their verified emissions. The Minister will take the requisite number of allowances from each emitters compliance account and put them into the Minister's retirement account to be extinguished.

Offsets, early reduction credits, and emissions units may all be used for compliance. The Québec rules also signify that emissions credits issued by Governments with whom Québec has an official agreement may also be accepted for compliance (and trading). This would allow Québec to accept emissions allowances from California in the event the two jurisdictions linked programs.

An emitter that achieves three consecutive annual emissions reports below the 25Kt emissions threshold will no longer be subject to compliance.

Failure to Comply

If an emitter does not have enough allowances in its compliance account, the Minister will suspend the emitter's general account and apply a penalty of three emissions allowances for each missing allowance needed to reach compliance. The Minister will access the emitter's general account to find the required allowances. If the general account does not have sufficient allowances, the emitter is given a 30-day notice to obtain them. If after 30 days, the emitter cannot produce the required allowances, the Minister will subtract the owed allowances from the emitter's next allowance allocation.

⁵ For more detail on program scope, see Title 1, Chapter 1 of the [regulations](#)



Allowance Allocation

In order to help ease competition concerns and carbon leakage issues, the Québec system will freely allocate allowances to the following sectors:

- Mining and quarrying sectors (excluding oil and gas sector);
- All manufacturing activity (including oil and gas sector);
- Steam and air conditioning suppliers;
- Electricity imports from jurisdictions that are covered under a separate cap and trade program but not linked to Québec's;
- Electric power generation sold under contract, with a fixed sale price, and signed before 1 January 2008 that has not been renewed or extended after that date⁶.

Québec will not provide free allocation for transportation emissions.

The Minister determines each year the number of emissions units that will be allocated without charge to each eligible emitter, based on efficiency benchmarks that are calculated through the various equations listed in Part II of Appendix C⁷. Between 2012 and 2014, allowances will be freely allocated based on an entity's average historic emissions intensity between 2007 and 2011 and adjusted for production output, with 100% allocation for process emissions, 80% for combustion emissions, and 100% for emissions from other sources.

From 2015 to 2020, allocation decreases annually determined by an emissions intensity target that also decreases annually. Different industrial activities will see different levels of decrease. As the emissions intensity targets decrease, fewer allowances are available for allocation, and conversely, more allowances will be auctioned.

On 12 January of each year (year X), the Minister issues the free allowances (units) corresponding to 75% of the total estimated quantity of emissions units that may be allocated without charge for the upcoming year. The remaining 25% of the total estimated quantity of free allocation is held back until September of the next year (year X+1), so as to give the Minister a chance to verify facilities' emissions reports (from year X) against the estimated amount made in January of year X. Once the analysis has been made and compared to the original allocation estimate in January of year X, the Minister adjusts the allocation amount accordingly and delivers (or rescinds) the remaining allocated allowances in September (year X+1). Therefore, emissions units allocated freely in January (year X) could be rescinded in September (year X+1), if the Minister determines that the original January (year X) allocation was over-estimated.

⁶ For the full language on electricity imports, see Annex C, Part I, Table A in the [regulations](#)

⁷ For complete allowance allocation detail and equations see Sections 39 through 44 and Appendix C, Part II in the [regulations](#)



This provision ensures that government allocates freely exactly the amount of allowances that firms are due according to the allocation calculations, without having to completely rely on emissions estimates based on previous years, which could prove inaccurate. In light of this provision, certain industries may wish to keep a buffer of allowances, particularly in compliance years, in case their allocated allowances from the previous year are rescinded due to overestimated emissions.

This risk of claw-back could have market implications and could prove interesting to explore as linking work develops between Québec and California, especially because no such provision exists in the California rules.

Allowance Reserve

As mentioned earlier, the Minister keeps an *allowance reserve account*. This account is made up of: 1% of the emissions units available under the cap set for the years 2013 and 2014; 4% of the emissions units available under the cap set for the years 2015 to 2017; and 7% of the emission units available under the cap set for the years 2018 to 2020.

This allowance reserve is used as a price ceiling, in just the same way as *California's Price Containment Reserve* is. If allowance prices rise to a pre-determined level, these reserve allowances will be made available in "sale by mutual agreement." Alternatively, the Minister may choose to use these reserve allowances to adjust the amount of free allowances allocated to emitters.

In the case of a sale by mutual agreement, the Minister will divide the emissions units in the reserve account equally into three categories to be sold at the following prices:

- Category A: \$40 per emission unit;
- Category B: \$45 per emission unit;
- Category C: \$50 per emission unit.

Beginning in 2014, these prices will increase annually by 5% (plus inflation). Only covered emitters not holding emissions units in their general account are eligible for a sale by mutual agreement. Emissions units purchased will go directly to an emitter's compliance account.

Allowance Auctions

The remaining emissions units that make up the total cap, which have not already been allocated freely, are auctioned to emitters and participants at most four times per year.

Sixty days before an auction, the Minister publishes a notice of auction. At least thirty days before the auction, emitters and participants must register with the Minister as a bidder.⁸

⁸ For required registration details see Section 46-48 of the [regulations](#)



At least seven days before the auction, a bidder must submit a financial guarantee in the amount equal to or in excess of the total the bidder plans to bid. If the payment guarantee is not used during the auction, it can be retained for an auction at a future date.

The auction of emissions units consists of a single round of bidding, using sealed bids. Emission units are auctioned in lots of 1,000 units of the same vintage.

Auction Floor Price

Auctions will see a \$10/tonne price floor starting in 2012 and rising 5% for each year thereafter (plus inflation). This floor price was changed from a \$15/tonne starting point originally set in the draft rules, presumably to match California's program and facilitate linking. Of note, California's floor remains at \$10/tonne for both 2012 *and* 2013 before rising 5% per year (plus inflation) starting in 2014. This discrepancy is worth paying attention to as the two programs discuss linking.

Auction Purchase Limits

Prior to 2015, at each auction there is a purchase limit for each bidder in proportion to the total emission allowances being offered.

No single *emitter* can buy more than 15% of 2013 or 2014 vintage allowances, nor can one buy more than 25% of vintage years 2015 and higher. Further, bidders classified as *non-emitter participants* are limited to 4% of 2013 and 2014 vintages. These participants are permitted to reach 25% for 2015 vintages and higher, however.

It has not been established whether there will be purchase limits for auctions beginning in 2015 and later.

When bidders are related entities, the purchase limit applies to all of those entities. When applying to the minister for auction registration, the related entities must disclose their relation and specify in percentages their preferred distribution of the overall purchase limit applied to each.

The Minister will award emissions units from the auction starting with the bidders that submitted the highest bids, until all available units have been sold or until the minimum floor price is reached. The winning bidder has 30 days to pay, at which point the Minister puts the emissions units into the bidder's general account. Emissions units that are unsold are retained for a future auction.

Holding Limits

In its final draft of regulation, Québec introduced a limit to the amount of allowances that an emitter or participant can hold onto to bank forward for future use, in order to prevent any one entity from gaining too large of a market share and manipulating the market. The annual holding limit is an average of approximately 1.6Mt per year. The holding limit does



not apply to emissions units in an emitter's compliance account destined for the current compliance period. Further, offsets are not subject to the holding limit.

The following equation is used to determine an entity's holding limit⁹:

$$HL_i = 0.1 \times \text{Baseline} + 0.025 \times (C_i - \text{Baseline})$$

Where:

- HL_i = Holding limit for year i ;
- 0.1 = Maximum proportion of the number of emission units constituting the Baseline that an emitter or a participant may hold;
- Baseline = 5,000,000, being the estimated number of emission units that will be auctioned in 2013;
- 0.025 = Maximum proportion of the number of emission units in excess of the Baseline and issued in year i that an emitter or a participant may hold;
- C_i = Annual cap of emission units for year i .

Once half of the holding limit is reached, the Minister can demand that the entity in question explain their strategy for doing so. The Minister can block any transaction that would put an emitter or participant above their holding limit.

Related entities are considered to be a single entity with an overall holding limit that they can distribute amongst themselves by allotting percentage shares. This distribution must be disclosed upon registration and before auctions.

Of note, if California and Québec link as planned, creating fully fungible allowances with joint auctions, holding limits will necessarily increase by virtue of the increased baseline of allowances in the systems (the two program's pooled allowances will create a larger baseline in the holding limit equation). The massive increase in the baseline from the influx of Californian allowances would significantly increase holding limits for individual entities in the Québec system.

Banking

While holding limits do exist, banking is allowed. That is, in any year, allowances saved from any previous year may be used for compliance or sold. Banked allowances never expire. The quantity of banked allowances, however, is subject to holding limits, as illustrated above.

⁹ For more details on the holding limit formula see Section 32 of [regulations](#)



Trading

Allowances, including offsets, early reduction credits, and all other emissions units approved by the Québec government, may be traded between registered emitters and participants. Only emissions allowances in a general account may be traded – once recorded in a compliance account, emissions allowances may only be used for compliance.

Within three business days of signing an agreement concerning the transaction of emissions allowances, the parties must send the Minister a transaction notice.¹⁰

Early Reduction Credits

Entities covered under the first compliance period (and only if they are covered under the first compliance period) that made investments leading to reductions in 2008 to 2011 may apply for early reduction credits. Emissions reductions in 2008-2011 will be compared to a 2005-2007 emissions reference period. Emitters must apply for early reduction credits by 31 December 2012¹¹.

Reductions are deemed ineligible if they occurred from a decrease in production or the closure of an establishment. Further, reductions are deemed ineligible if they were offset by an increase in GHG emissions at another establishment located in Québec or elsewhere.

For credits to be awarded, the reductions must have been voluntary, permanent, irreversible, and additional. However, reductions in GHG emissions resulting from on-site transportation activities and the sequestration of GHG emissions are not eligible for early reduction credits.

Substitutions to a less emissions-intensive fuel may qualify but only if one of the following conditions apply:

- The average purchase cost of the substitute fuel paid by the emitter during the reduction period must be higher than the average cost of the fuel substituted during the reference period; *or*
- The emitter must have made an investment, other than an equipment maintenance investment, to modify or replace equipment in order to substitute the fuel during the eligibility period.

¹⁰ For detailed information on required information to be included in a transaction notice, see Section 25 of the [regulations](#)

¹¹ There is a maximum amount of early reduction credits that an emitter can achieve calculated using equations 69-1 to 69-5 in the [regulations](#).



Offsets

Québec has not yet developed its offsets methodology. It is expected to do so by mid-2012. It is reasonable to believe that the province will fall in line with four or five offsets protocols approved for the Californian system, though Québec could theoretically accept more lenient offset protocols, which could have the effect of easing compliance costs in a future linked system.

WCI members are currently working towards developing four to five common offsets protocols to be released imminently, which could effectively coordinate certain protocols between jurisdictions like California and Québec.

Interesting to watch for is whether Québec will mirror California's buyer-liability policy, whereby the purchaser – not the project developer – of an offset credit is held responsible if that offset is later deemed invalid. This clause is expected to stunt offset developments in the California system, and could do the same if adopted by Québec, ultimately restricting offset supply and increasing abatement costs.

Like California, Québec offsets are subject to an 8% usage limit. That is, no more than 8% of an entity's total compliance obligation for each compliance period can be satisfied using offsets.

Market Oversight:

It is expected that the Québec Securities Commission will oversee primary market activities relating to entities operating within the province.

Revocation:

Québec Minister of Sustainable Development, Environment and Parks can suspend, withdraw, or cancel any allowance granted by the minister for the following infractions:

- Use of false or inaccurate information to attain compliance instruments;
- Violations of the regulation; or
- Any other reason determined by government regulation.



About IETA

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