CLEAN ENERGY CANADA

SUBMISSION

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Driving Effective Carbon Markets in Canada

Clean Energy Canada is a climate and clean energy program within the Morris J. Wosk Centre for Dialogue at Simon Fraser University.

We are pleased to submit these comments as part of the Government of Canada's consultation on developing an updated benchmark for the output-based pricing system (OBPS).

Summary

As the federal government reviews the benchmark for industrial pricing systems, any re-design must meet the following objectives:

1. Establish long-term price certainty
2. Enforce a minimum effective credit price close to the headline price
3. Ensure effective markets with sufficient liquidity
4. Facilitate transparency of credit prices and availability
5. Maintain stringency
6. Protect industrial competitiveness to prevent adverse economic impacts, while avoiding overly generous exceptions
7. Review fossil fuel-fired electricity sector treatment under OBPS—including common coverage requirements—with an eye to facilitating effective future Clean Electricity Regulation equivalency agreements with provinces.

To achieve these objectives, any changes to the federal benchmark should:

- Set a headline price schedule to 2035, increasing consistently by at least the rate of the 2023 to 2030 price schedule (i.e. a $15 increase annually).
- Set a minimum effective credit price schedule for 2027 to 2035, alongside the headline price that all provincial and territorial (PT) industrial pricing systems need to comply with.

- Consistently enforce the minimum carbon price requirement.
- Assess equivalency of PT pricing systems based on outcome, as opposed to market mechanics, and effectively enforce equivalency to open up the possibility of cross-market credit trading.
- Establish a central registry for credit trading and require regular (at least quarterly) reporting of credit trading activity to support the publication of aggregated, anonymized data on average trading prices.
- Require annual reports on compliance obligations and credit holdings.
- Set an ambitious minimum annual tightening rate for performance standards.
- Require in regulation periodic reviews on emissions-intensive, trade-exposed (EITE) provisions to assess sectoral impacts, including through forecasted impacts on sectoral GDP, sales, and profits.
- Consider greater exposure of fossil fuel-fired electricity sector emissions to the full industrial carbon price, and evaluate options that address any resultant pass through of costs onto ratepayers.

Detailed recommendations

The Government of Canada's OBPS plays a critical role in ensuring that all large industrial emitters face a carbon price that meets a minimum standard for stringency. A minimum standard is particularly important given the OBPS's emphasis on enabling provincial and territorial flexibility through the creation of unique systems. As the federal government reviews the current benchmark—especially in the context of potentially greater interplay between the OBPS and the clean electricity regulations (CER) as federal and provincial governments explore CER equivalency agreements—it is vital that several core objectives are maintained in order to protect the integrity of the policy as a tool for reducing industrial greenhouse gas emissions.

1. Establish long-term price certainty

Price certainty and predictability are crucial for the effectiveness of carbon pricing systems. Companies need a reliable long-term trajectory on the cost of carbon and their ability to trade credits to earn back the investments they make in clean technology.

With the removal of the consumer carbon price—plus the consideration of removing other key regulations such as the CER and oil and gas emissions cap—the Government of Canada has highlighted the critical importance that the industrial carbon price will play in driving emission reduction in Canada. It is therefore vital that any reforms to the benchmark continue to provide a clear long-term signal that is at least as strong as the existing trajectory.

The federal benchmark should:

- **Set a headline price schedule to 2035, increasing consistently by at least the rate of the 2023 to 2030 price schedule (i.e. a $15 increase annually).**

2. Enforce a minimum effective credit price close to the headline price

The headline carbon price provides an important market signal for decarbonization and investment in clean technology. However, the effective price of credits on the market can fall far below the headline credit price if systems are designed ineffectively.

Alternate compliance pathways in pricing systems can provide flexibility for regulated entities; however, incorporating too many compliance pathways and flexibilities can also flood the credit market, driving down the price of credits, compromising the credit market's integrity and weakening the policy's effectiveness. Examples of compliance pathways that risk undermining industrial carbon pricing systems in these ways include: allowing compliance through lower-cost, low-quality offset credits; issuing additional credits for capital investments; and allowing unlimited banking of credits from previous compliance years.

Regulators have several options to prevent effective credit prices from falling far below the headline price. These include:

- limiting the use of offsets for compliance,

- ensuring benchmarks are sufficiently stringent, and
- implementing a market stability mechanism.

Rather than being prescriptive in systems design, the federal government should set and consistently enforce an effective minimum credit price. The November 2025 Canada-Alberta Memorandum of Understanding committed to a minimum effective credit price of $130/tonne under TIER. This is a good start, but a minimum effective credit price should apply to all PT systems and be set annually.

The federal benchmark should:

- **Set a minimum effective credit price schedule for 2027 to 2035, alongside the headline price that all PT industrial pricing systems need to comply with.**
- **Consistently enforce the minimum carbon price requirement.**

3. Ensure effective markets with sufficient liquidity

Currently, some of Canada's provincial systems cover a relatively small number of regulated entities, resulting in small credit markets with low liquidity. Similarly, some credit markets are dominated by industries with a relatively high marginal abatement cost, while others comprise more regulated entities that create credits. A shared market or the possibility of cross-market trading of credits could increase the efficiency of the carbon trading system and equalize credit prices across the country. However, this requires that markets have similar stringency based on an assessment of equivalency. Equivalency of provincial systems must be determined in terms of outcomes, however, as opposed to market mechanics. In other words, systems should deliver an effective minimum credit price consistent with the federal benchmark in a given year to be deemed equivalent.

The federal benchmark should:

- **Assess equivalency of PT pricing systems based on outcome, as opposed to market mechanics, and effectively enforce equivalency to open up the possibility of cross-market credit trading.**

4. Facilitate transparency of credit prices and availability

There is currently insufficient public data on actual market prices for compliance credits, which means it is hard for both governments and stakeholders to assess the effectiveness of carbon pricing systems. Moreover, some of the measures necessary to ensure effectiveness of pricing systems (including the enforcement of a minimum effective credit price) require transparent data on credit trading prices. Other jurisdictions with industrial carbon pricing, including the European Union and California (whose carbon market is linked with Quebec's) publish such information on a regular basis.

The federal benchmark should:

- **Establish a central registry for credit trading and require regular (at least quarterly) reporting of credit trading activity to support the publication of aggregated, anonymized data on average trading prices.**
- **Require annual reports on compliance obligations and credit holdings.**

5. Maintain stringency

As regulated entities respond to the carbon price signal by reducing their emissions, the average emissions of production will reduce. For industrial pricing systems to remain effective, it is therefore crucial that benchmarks are continuously tightened. Annual tightening rates should be increased to prevent oversupply of credits. For comparison, the EU Emissions Trading System applies an annual reduction in the overall cap of emissions (and freely allocated allowances) of 4.3% per year over the period 2024-2027 and 4.4% per year from 2028.

The federal benchmark should:

- **Set an ambitious minimum annual tightening rate for performance standards.**

6. Protect industrial competitiveness to prevent adverse economic impacts, while avoiding overly generous exceptions

Policy design should carefully balance competitiveness concerns, especially in the current economic climate, with the real risk of overly generous EITE designation and protection. The Commission on Carbon Competitiveness published modelling assessing the vulnerability of emissions-intensive, trade exposed sectors, based on a range of indicators including expected GDP growth and financial impact in each sector. This modelling showed that, while some sectors (including steel, pulp and paper, basic chemicals, and agricultural chemicals) face substantial risk of leakage this decade, others including conventional oil and gas, oil sands, petroleum refineries, and aluminum show a relatively lower risk of lost market share. As such, generous exceptions or inflated performance standards for less exposed sectors are unnecessary.

The federal benchmark should establish a fair and consistent test for determining which sectors are at risk of carbon leakage. The same test should be applied across systems so that facilities within the same sector are treated equally across provinces.

The federal government should also consider long-term strategic policy to counter carbon leakage while still incentivizing decarbonization, including the implementation of a carbon border adjustment mechanism in tandem with like-minded trading partners.

The federal benchmark should:

- **Provide a clear test to determine which sectors should be designated as EITE, including through forecasted impacts on sectoral GDP, sales, and profits.**

7. Review fossil fuel-fired electricity sector treatment under OBPS—including common coverage requirements—with an eye to facilitating effective future Clean Electricity Regulation equivalency agreements with provinces.

The OBPS plays an important role in helping drive emission reductions in the electricity sector. By raising the costs of fossil fuel-fired power generation with a long-term pricing signal, the generation mix will gradually shift towards lower and non-emitting options.

However, the current application of the OBPS to the electricity sector undermines its effectiveness. By treating electricity as an emissions-intensive and trade-exposed sector, despite having no real competitiveness issues justifying this treatment, the OBPS is failing to apply the full price signal to all relevant emissions, unduly undermining the competitiveness of non-emitting options.

This challenge is particularly relevant in the context of the Canada-Alberta Memorandum of Understanding, which considers suspension of the recently developed Clean Electricity Regulations in favour of a new carbon pricing agreement. The removal of the CER's application in any province will shift the electricity-related emissions-reducing burden onto that province's industrial carbon pricing system. A thoughtful review of how fossil-fired electricity generation is treated under the federal OBPS is therefore required to carve a path for achieving meaningful emission reductions through provincial industrial carbon pricing systems, enabling a provincial industrial carbon pricing system to serve as one aspect of a comprehensive CER equivalency agreement.

The federal benchmark should:

- **Consider greater exposure of fossil fuel-fired electricity sector emissions to the full industrial carbon price, and evaluate options that address any resultant pass through of costs onto ratepayers.**