

Carbon Competitiveness Incentive Regulation

Cost Containment Introduction

June 12, 2018

Overview

- Context
- Other regulatory amendments
- Qualification criteria
 - Incremental costs
 - Thresholds
- Application process
 - Required submission
 - Deadline/timing
 - Assurance elements
- Designation and benefit
- Reporting
- Q&A

Context

- The *Carbon Competitiveness Incentive Regulation* (CCIR) came into effect on January 1, 2018.
- Included transition allocations to transition from SGER to CCIR.
- Commitment to further work to create cost containment mechanism.
- Development of cost containment informed by discussions with stakeholders and further assessment by regulated entities of the finalized CCIR.

Other Regulatory Amendments

- Correction to opt-in provisions to allow smaller facilities in emissions intensive trade exposed sectors to opt-in if a larger competitor has done so.
- Extension of opt-in deadline for 2018 and 2019 to September 1, 2018.
- Extension of new facility exemption from up to two years to up to three years.
- Mechanism to deal with potential problems encountered by new facilities during commissioning.
- Correction to hydrogen established benchmark and resulting adjustment to established benchmark for softwood pulp

Cost Containment Qualification

- To qualify incremental costs under CCIR must be higher than defined percentage of sales or profits.
 - Forecast based for years 2018 through 2022
 - Incremental costs are the difference in forecast of the true-up obligation under the CCIR at the scheduled price and forecast of tonnes owed under the SGER of 2015 (12% reduction target) at \$15/tonne plus tax and royalty impacts.
 - Royalties are forecast under the CCIR and under the 12%, \$15/tonne SGER.
 - Tax effects are estimated at 27% of the difference in compliance costs (SGER-CCIR).

Cost Containment Qualification

- If incremental costs exceed either 3% of forecast sales or 10% of forecast profits the facility would qualify for that year.
 - Forecast sales is calculated as the forecast production times the forecast weighted average sales price.
 - Profits are forecast as forecast sales times profit margins by sector.

- *Facility Sales Ratio =*

$$\frac{CCIR \text{ tonnes owed} \times \text{fund price} - \text{Basline Obligation} \times \$15 + \Delta Tax + \Delta Royalty}{Product Sold \times Sales Price}$$

- *Facility Profit Ratio =*

$$\frac{CCIR \text{ tonnes owed} \times \text{fund price} - \text{Basline Obligation} \times \$15 + \Delta Tax + \Delta Royalty}{Product Sold \times Sales Price \times Sector Profit Margin}$$

Application Process – Required Submission

- Application for cost containment designation
 - Application form
 - Baseline Obligation form
 - Forecast for the facility
 - Financial statements
 - Emissions reduction plan
 - Statement of Validation for emissions reduction plan
 - Statement of Certification for package
- For 2018 designation application needs to be received on or before Nov 1, 2018
- For subsequent years by Nov 30 of the year preceding first requested designation

Application Process – ERP

- Emissions Reduction Plan – what is the path to intensity improvements if accepted to cost containment
 - Sources addressed by the plan
 - Description of each emissions intensity improvement project
 - Baseline to be used for each project
 - Projected emissions intensity improvement
 - Schedule and milestones
 - Monitoring plan
 - Cost estimates
 - Applications for grants/cost supports
 - Forecast usage of credits

Application Process – Financials

- Facility level financials for prior 3 calendar years
 - Total quantity of each product produced
 - Weighted mean sales price
 - Royalties paid and the relation of production and sales price reported to those used for royalties determination
 - Audit of financial statement

Application Process

Validation and Audit Requirements

- Validation and auditing are assurance requirements for the cost containment program.
- The purpose of validation and auditing is to provide assurance that the information submitted for the cost containment program are materially correct and meets the intent of the program.
- Standard for Validation, Verification and Audit:
 - “Standard for Verification” updated to include validation and audit requirements
 - New and updated terminologies added to the regulation and standard:
 - “Third party assurance provider” replaces “third party verifier”
 - “Audit” is a requirement for financial statements
 - “Validation” is a requirement for emissions reduction plans

Application Process

Validation and Audit Requirements

- Audit Requirements for Financial Statements:
 - Financial statements submitted as part of a cost containment application or annual emissions reduction plan report must be audited.
 - Qualifications of an auditor are outlined in Part 1 of the Standard for Validation, Verification and Audit:
 - Audit team must include a Lead Auditor and Independent Reviewer
 - Minimum of 5 years of experience in auditing financial statements
 - *Canadian Auditing Standard and Chartered Professional Accountants Handbook*
 - Audit Quantitative Materiality Threshold:
 - Total identified quantifiable errors, omissions or misstatements exceed:
 - 5% of products sold for a facility with TRE < 500,000 tonnes CO₂e
 - 2% of products sold for a facility with TRE > 500,000 tonnes CO₂e
 - Total identified quantifiable errors, omissions or misstatements result in a difference in the Facility Sales Ratio ≥ 0.0006 .
 - Total identified quantifiable errors, omissions or misstatements result in a difference in the Facility Profit Ratio ≥ 0.002 .

Application Process

Validation and Audit Requirements

- Audit Requirements for Financial Statements (cont.):
 - Additional activities for auditing financial statements in cost containment applications:
 - Contact ACCO prior to initiation of audit engagement
 - Provide ACCO with Audit Plan for review prior to initiation of audit engagement
 - Allow ACCO participation in kick-off, close-out, and other meetings during the audit process
 - Intent of ACCO involvement is to provide guidance and clarity on audit criteria and process.
 - ACCO involvement in the audit engagement has no bearing on the outcome of the audit or influence the Minister's decision to assign cost containment designation.
 - Facility at a higher risk of re-audit or review if ACCO does not participate in audit process as part of cost containment application process.
 - Audit of financial statements in emissions reduction plan report submissions do not require ACCO participation.

Application Process

Validation and Audit Requirements

- Validation Requirements for Emissions Reduction Plan:
 - Validation process similar to verification process except is a forward-looking process to evaluate the validity of the assertion made by the facility.
 - Validators and verifiers are referred to as “third party assurance providers” in which the activities conducted are different, but the qualifications required of validators and verifiers are the same.
 - Validation Quantitative Materiality Threshold:
 - Total identified quantifiable errors, omissions or misstatements >5% of total emissions reductions targeted in the emissions reduction plan.
 - Qualitative assessment:
 - Assess appropriateness of baseline emissions scenario for the facility.
 - Assess whether there is sufficient evidence to support the assertion claimed by facility.
 - Assess whether the proposal for emissions reductions in a given timeframe can be reasonably achieved.
 - ACCO may request re-validation if the findings are found to be insufficient.

Designation

- A facility may be designated under sections 34.4 (reporting requirements) and under 34.6 (cost containment measures)
- This allows for a facility to be designated early for a later period though they take on the annual reporting requirements.
- Designation will come with terms and conditions, many informed by the emissions reduction plan.
- Designation may be revoked:
 - At request of the person responsible
 - If terms and conditions are not met
 - Facility enters bankruptcy
 - If cost containment is no longer required
 - Economic test
 - Other forms of support

Benefits

- If designated under 34.6 benefits of cost containment include:
 - Full compliance flexibility to use credits
 - Access to designated funding for industrial energy efficiency (coordinated grant program)
 - Cost containment allocation benchmark can be issued where previous two elements do not relieve economic hardship

Industrial Energy Efficiency Funding

- If providing full compliance flexibility doesn't provide enough relief, facilities will be eligible for industrial energy efficiency (IEE) funding via grants
- IEE funding can be for an amount up to the total of a facility's cumulative compliance obligation up to 2022
- However, IEE funds will be tied to projects as identified by a facility's emissions reduction plan
- Once a facility's application is processed and is deemed eligible for IEE funds , ACCO will work with applicants to gather any additional information needed, identifying timelines for projects, and milestone-based grant disbursements

Cost containment allocation benchmarks

- The compliance cost containment benchmark allocation for a product (BCCA) will be calculated so that the facility will no longer exceed the sales or profit thresholds, net of the cost containment benefits received via compliance flexibility and any benefits received which originate from the CCEMF or the carbon levy, excluding those funds used for adaptation.
- Cost containment allocation benchmarks would be approved based on forecast values but are calculated after year end based on facility actual performance
 - Would be subject to verification and based on audited facility financials
 - Level of allocation considers the value of compliance flexibility, the benefits of grants received as well as tax and royalty interactions
 - Allocation is sufficient to move the facility out of economic hardship as defined in the standard

Reporting – emissions reduction plan report

- Reporting on those quantities specified in the emissions reduction plan, including
 - Audited financial statement
 - Completed baseline obligation form
 - Any cost containment relief mechanisms or other government benefits received
 - Evaluation of economic hardship tests
 - Tax and royalty scenarios
 - Reporting on execution of the emissions reduction plan
 - Evaluation of economic hardship tests with and without cost containment benefits
- May include an updated emissions reduction plan

Q & A