Examining Ontario's Departure from the Western Climate Initiative: Implications for Infranational Administrative Cooperation in the North American Regional Carbon Market

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Abstract

This article offers a critical examination of Ontario's brief participation and sudden departure from the Western Climate Initiative (WCI) common carbon market in 2018. It reviews the mechanisms of cooperation within the WCI framework and the legal repercussions of Ontario's withdrawal. Finally, it draws insights into the dynamics of the WCI cooperative model, highlighting its resilience but also its vulnerability to regulatory risks, which can undermine the stability of the common carbon market. The study concludes that clear procedural rules and compensatory mechanisms would help mitigate regulatory unpredictability.

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1. Introduction

The Western Climate Initiative (WCI), particularly the California-Québec common carbon market, stands as a pioneering cooperative effort among North American subnational jurisdictions aiming at tackling climate change via cap-and-trade programs.

It was established in February 2007, via an accord signed by the Governors of Arizona, California, New Mexico, Oregon, and Washington. By 2008, British Columbia, Manitoba, Ontario, and Québec had joined the initiative with the shared goal of inaugurating a harmonized transnational emission allowance market by January 1, 2012. However, by that date, several US states and Canadian provinces had withdrawn from the WCI. California initiated its cap-and-trade program in 2012, followed by Québec in 2013; the two programs were subsequently linked in 2014.

After comprehensive harmonization work conducted in collaboration with Québec and California, Ontario launched its cap-and-trade program in 2017. The program maintained a brief linkage with those of Québec and California from January to June 2018[1].

Other subnational jurisdictions have used the Western Climate Initiative framework to establish their own cap-and-trade programs but without joining the common carbon market. Nova Scotia initiated its program in 2019 and will terminate it in December 2023, while the State of Washington implemented its cap-and-invest program in January 2023[2].

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[1] For a detailed history of the WCI see H. Trudeau, *The Cap-and-Trade System for Greenhouse Gas Emission Allowances: The Quebec Experience*, in A.R. Lucas & A.E. Ingelson (eds.), *Environment in the courtroom*, (2022), 369; F. Roch & J. Papy, *L'Entente de liaison des marchés du carbone de la Western Climate Initiative : enjeux institutionnels et juridiques pour le Québec*, 49 RGD 67, 75 (2019); D.V. Wright, *Cross-Border Constraints on Climate Change Agreements: Legal Risks in the California-Quebec Cap-and-Trade Linkage*, 46 Envtl. L. Rep. News & Analysis 10478 (2016).

[2] International Carbon Action Partnership, *Nova Scotia Transitions to New Carbon Pricing System*, (2023), https://icapcarbonaction.com/en/news/nova-scotia-

While the initiative has been hailed for its achievements, its framework presents significative legal vulnerabilities. The examination of these vulnerabilities is not novel. Notable scholars in the US and Canada, such as Michael Mehling, David Wright, and Géraud de Lassus, have already provided valuable insights, with respect to the early phases of operation the WCI and the linking process between the California and Québec cap-and-trade programs.

This case study seeks to contribute to the conversation surrounding the WCI framework by focusing on the linkage and subsequent delinkage of the Ontario cap-and-trade program and by gleaning insights into the WCI's scalability and long-term viability. It reviews the mechanisms of interjurisdictional cooperation within the WCI framework (Section 1), explores Ontario’s departure from the common carbon market (Section 2), and lastly, offers insights derived from the WCI cooperative model’s dynamics (Section 3).

2. How do WCI partners cooperate?

The WCI cooperative model attempts to navigate the dual challenges of harmonization and decentralized governance. It is characterized by an iterative process built around common objectives and guidelines (2.1), marked by US Law dominance (2.2), and a highly decentralized linkage architecture (2.3).

2.1. Iterative cooperative process built around common objectives and guidelines

This section describes the main objectives of the WCI's linkage arrangements, the underlying mechanisms employed to achieve these goals, and explores the decentralized rulemaking process that characterizes the initiative.

The main objectives of the Western Climate Initiative cooperation center around two primary goals. First, the aim is to enhance the efficiency of the partners' respective Cap-and-trade programs by strategically reducing compliance costs for covered entities and minimizing administrative costs for regulators. Second, the WCI seeks to augment the Greenhouse Gas (GES) mitigation

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transitions-new-carbon-pricing-system (last visited Aug 21, 2023); International Carbon Action Partnership, *Presentation of the Washington State (USA) Cap-and-Invest Program*, (2023), https://icapcarbonaction.com/en/ets/usa-washington (last visited Aug 21, 2023).

objectives for partnered jurisdictions, aligning these efforts with broader regional environmental goals. It is designed not only to elevate mitigation efforts but also to preserve and reinforce the environmental integrity of the system across the entire region.

These goals are primarily achieved through the following three mechanisms. First, the mutual recognition of emission rights fosters interoperability and enables partners to sustain a common carbon market. Secondly, the utilization of common auctions supports a unified and transparent primary market structure for the introduction of emissions allowances at the regional level. Thirdly, a shared technological platform centralizes administrative and technological services that are essential to the effective functioning of the linked Cap-and-trade systems. This facet of the WCI institutional arrangements is further elaborated in the next section.

The Western Climate Initiative (WCI) differs from other carbon market frameworks like the EU Emissions Trading System and the Regional Greenhouse Gas Initiative (RGGI) in that it does not rely on a shared regulatory foundation or model rule. Instead, each partner has developed its own regulatory architecture, based on general guidelines. These guidelines were developed between 2007 and 2010, following extensive consultations with stakeholders. They are described in the *Design Recommendations for the WCI Regional cap-and-trade Program* (2008) and the *Design for the WCI Regional Program* (2010)[3].

In effect, rulemaking within the Western Climate Initiative (WCI) is characterized by a fully decentralized process, reflecting the diverse regulatory landscapes of its partners.

WCI cap-and-trade programs are tailored to reflect the unique circumstances of each member jurisdiction. Consequently, there are noticeable disparities among them, including greenhouse gas reduction targets, free allowances distribution methodologies, and specific rules and protocols for offsets. This explains why, even

[3] Western Climate Initiative, *Design Recommendations for the WCI Regional Cap-and-Trade Program*, (2008), https://wcitestbucket.s3.us-east-2.amazonaws.com/amazon-s3-bucket/documents/en/wci-program-design-archive/WCI-DesignRecommendations-20090313-EN.pdf; Western Climate Initiative, *Design for the WCI Regional Program*, (2010), https://wcitestbucket.s3.us-east-2.amazonaws.com/amazon-s3-bucket/documents/en/wci-program-design-archive/WCI-ProgramDesign-20100727-EN.pdf.

after linking, Québec and California respective programs have developed in differentiated ways.

The essence of this kind of cooperation lies in the continuous consultation between the partners, making the process highly dynamic and contingent on trust and a consistent exchange of information. This approach has led to successive waves of harmonization between the California and Québec programs, with a fifth wave currently in progress[4].

The overall cooperative process underpinning the harmonization and integration of cap-and-trade programs within the Western Climate Initiative (WCI) is captured through two formal agreements. In 2013, California and Québec entered into an *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*, preceding the 2014 linkage[5]. Subsequently, in 2017, California, Québec, and Ontario signed an *Agreement on the Harmonization and Integration of cap-and-trade Programs for Reducing Greenhouse Gas Emissions*, ahead of the 2018 linkage[6]. The 2017 Agreement, however, largely retains the structure and content of the previous agreement and will be further described in section 1.3.

2.2. Institutional arrangements characterized by outsourcing and US Law dominance

WCI's institutional arrangements are characterized by outsourcing practices and U.S. legal dominance, revealing a multifaceted interplay of administrative and legal dynamics.

[4] For a description of the mechanics of the first two waves of harmonization see G. De Lassus Saint-Geniès, *Quel droit pour l'interconnexion des marchés du carbone ? Un regard sur l'expérience Québec-Californie*, 42 RJENV 157 (2017).

[5] California & Québec, *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*, (2013), https://ww2.arb.ca.gov/sites/default/files/cap-and-trade/linkage/ca_quebec_linking_agreement_english.pdf (last visited Aug 14, 2023) [2013 Harmonization Agreement].

[6] California, Ontario, & Québec, *Agreement on the Harmonization and Integration of Cap-and-Trade Programs for Reducing Greenhouse Gas Emissions*, (2017), https://ww2.arb.ca.gov/sites/default/files/cap-and-trade/linkage/2017_linkage_agreement_ca-qc-on.pdf [2017 Harmonization Agreement].

WCI partners have delegated several core administrative and technological functions of their cap-and-trade programs to WCI Inc., a non-profit corporation organized under the laws of Delaware. WCI Inc.'s role includes the maintenance of a central registry (known as the Compliance Instrument Tracking System Service or CITSS), to track emission allowances and offset credits. WCI Inc. has also been mandated to conduct common auctions and to monitor all emissions rights transactions on both primary and secondary markets[7]. Following public tenders, WCI Inc. has in turn subcontracted the performance of these tasks to various private entities[8]. Financing of WCI Inc. is allocated by the WCI partners based on the relative size of their programs. For the fiscal year 2023, WCI Inc. has a budget of approximately 12.4 million USD[9].

American law is applicable to all aspects of the performance of WCI inc.'s core duties including with respect to tenders, centralized registry, common auctions and transaction monitoring tasks. This dominance and the limited scope of Québec's law raises several questions about the interplay between legal frameworks in WCI cross-border governance. Notably, it creates a significant issue concerning public finances for Québec, as the province's Auditor General does not possess the authority to audit outside its territory. Presently, audits are carried out by Clifton Larsen LLP, an accounting firm mandated by WCI Inc. This situation highlights a vulnerability in Québec's financial oversight capabilities, raising concerns about the efficacy and transparency of the auditing process within the WCI framework[10].

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[7] For a complete description of WCI inc. tasks delegation, see WCI Inc., Greenhouse gas emissions trading: a cost-effective solution to climate change, WCI, Inc. (2023), https://wci-inc.org (last visited Aug 15, 2023).

[8] As of April 2023, General Dynamics Information Technology maintains the common tracking registry, Deutsche Bank National trust Company provides services related to allowances auctions and Monitoring Analytics, LLC provides market monitoring, see *Id.*

[9] For detailed financial informations about WCI Partners respective contribution see WCI, Inc., Budget Documents, https://wci-inc.org/documents/budget-documents (last visited Aug 15, 2023).

[10] Auditor General of Québec, *Report of the Sustainable Development Commissioner "Chapter 4 : Carbon Market Description and Issues,"* 34 (2016), https://www.vgq.qc.ca/Fichiers/Publications/rapport-cdd/2016-2017-CDD/en_Rapport2016-2017-CDDE.pdf (last visited Aug 15, 2023).

2.3. Decentralised linkage architecture

The linkage architecture in the Western Climate Initiative (WCI) is multi-layered and reflects a complex integration system. It can be visualized as a three-tiered structure, comprising partners' administrative laws and regulations, the aforementioned delegation of administrative and technological services to WCI inc., and formal agreements describing the continuing harmonization process between the cap-and-trade programs.

Contrary to a common misconception, the core legal foundation for linkage is not rooted in the 2013 or 2017 Agreements but anchored in domestic administrative rules and regulation. These provide for key linkage elements such as joint auctions, mutual recognition of emission rights or mutual recognition of administrative decisions (for example in the case of offsets invalidation).

This explains why the process for linkage within the Western Climate Initiative (WCI) may vary from one partner jurisdiction to another. For example, in California, Senate Bill 1018 requires that the Governor makes four distinct equivalency findings related to the environmental stringency of the program, respectively the unimpeded ability of California to enforce its laws, the assurance that enforcement in case of non-compliance in the other jurisdiction is as stringent as in California, and the guarantee that linkage does not impose significant liability on the state[11]. Conversely, Québec's legal approach to linkage is more straightforward and effectuated by a simple governmental decree[12].

From a functional standpoint, the 2017 Agreement aims to promote the protection of the environmental integrity of regional greenhouse gas emission reduction targets[13], mutual recognition of

[11] For more details about the equivalency findings process, see Governor E.G. Brown Jr., *SB 1018 Request for Cap-and-Trade Program Equivalency Findings*, https://www.ca.gov/archive/gov39/2013/02/26/news17933/index.html (last visited Aug 15, 2023).

[12] Gazette officielle du Québec, *Décret 1184-2012 Modifiant Le Système de Plafonnement et d'échange de Droits d'émission de Gaz à Effet de Serre*, (2012), https://www.publicationsduquebec.gouv.qc.ca/gazette-officielle/la-gazette-officielle-du-quebec/.

[13] Article 8 seeks to ensure transparent accounting and regional allocation of greenhouse gas (GES) emission reductions to prevent double counting, see California, Ontario, & Québec, cit. at 6.

emission rights[14], common auctions[15], carbon market oversight[16] and the deployment of a common technological infrastructure through WCI inc.[17] It also outlines the cooperation modalities between the parties to ensure the harmonization and integration of their respective programs. For example, continuing work related to the above-mentioned topics is conducted through dedicated workgroups under the supervision of a consultation committee composed of official representatives of each Party[18].

More relevant to the subject of this paper, it specifies the procedures to be followed for the accession of a new jurisdiction as well as the withdrawal of a Party[19]. Interestingly, these provisions signal a forward-looking perspective, contemplating potential expansions or retractions within the WCI common carbon market and are completed by dispute resolutions dispositions[20].

The fact that the legal basis for linkage does not stem from the 2013 and 2017 Agreements, but rather originates from domestic administrative regulation, raises interesting questions, particularly concerning the model's resistance to political risk and its capacity to sustain long-term market engagement with other jurisdictions. These issues were tested in 2018 when Ontario abruptly retracted its participation.

3. The case of Ontario's withdrawal from the WCI common carbon market

Ontario's withdrawal in 2018 was the first resilience test of the WCI linkage arrangements (3.1) and had wide legal repercussions (3.2).

3.1. Ontario's Withdrawal in Light of WCI Cooperative Arrangements

Ontario's cap and trade program was initiated on January 1st, 2017. Prior to linking with California and Québec, the province

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[14] Art. 6 of *Id.*
[15] Art. 9 of *Id.*
[16] Art. 11 of *Id.*
[17] Art. 12 of *Id.* For a detailed analysis of the 2017 Agreement, see F. Roch & J. Papy, cit. at 1.
[18] Art. 3 and 13 of California, Ontario, & Québec, cit. at. 6.
[19] Art. 19 and 17 of *Id.*
[20] Art. 20 of *Id.*

conducted four separate auctions, for which WCI Inc. provided administrative, financial, and technical services. On January 1st, 2018, Ontario's linkage with both California and Québec formally took effect. Two common auctions were then coordinated among the WCI partners, specifically on February 21st, 2018, and May 15th, 2018[21]. A third common auction was due to take place on August 14th, 2018. The 2018 Ontario provincial elections proved to be a pivotal moment for the province's climate change policy.

The Ontario conservative party led by Doug Ford won the provincial elections on June 7th, 2018. The centerpiece of its campaign was a promise to eradicate all forms of carbon pricing, dismantle the cap-and-trade program, and challenge the constitutionality of the Canadian federal carbon tax. Following its victory, the new conservative government was set to be instated on June 29th, 2018.

On the morning of June 15th, 2018, Doug Ford, as Premier-Designate, held a press conference in which he detailed the immediate plans following his government's inauguration, including, as promised, the termination of the cap-and-trade program and the challenge to the federal carbon tax. He then announced that Ontario would be serving notice of its withdrawal from the WCI and that he had directed officials to cease participation in future common auctions. Ford further promised the government would provide clear rules for the orderly wind down of the program[22]. The choice of June 15th for the press conference is believed to have been strategic, as it was the last day for Ontario to communicate its decision regarding participation in the August 14th common auction. Questions were immediately raised about these announcements, particularly in relation to the obligations contained in art. 16 and art. 17 of the 2017 Agreement.

Art. 16 provides for public announcement, and states that "*The Parties shall keep each other informed in advance of any public announcement related to their respective programs*" and furthermore

[21] See Ontario Cap-an-Trade Past auction information and results, http://www.ontario.ca/page/past-auction-information-and-results (last visited Aug 16, 2023).

[22] News release *Premier-Designate Doug Ford Announces an End to Ontario's Cap-and-Trade Carbon Tax*, news.ontario.ca (2018), https://news.ontario.ca/en/release/49621/premier-designate-doug-ford-announces-an-end-to-ontarios-cap-and-trade-carbon-tax (last visited Aug 16, 2023).

that "*Any announcement concerning the harmonization or integration of the Parties' programs shall be prepared and, if possible, made public jointly*". Despite the strong wording of this provision, the Premier-Designate's announcement was not made jointly with Québec and California. It also appears that they were not given advance notice[23].

This prompted the Québec government, a few hours after the Premier-Designate's declaration, to publish a press release reassuring Québec market participants of the province's commitment to cap-and-trade and the WCI common market, and to announce collaboration between Québec and California to protect the carbon market integrity[24]. Later that day the California Air Resources Board announced, in the joint name of Québec and California, the suspension of all transactions with Ontario accounts in order to safeguard the integrity of the carbon market[25].

In effect, at the close of June 15th, transfers could not be made between Ontario accounts and Québec or California accounts, effectively de facto suspending market linkage with Ontario. Ontario participants could however continue trading among themselves.

Article 17 of the 2017 Agreement sets out the withdrawal procedure from the common carbon market. It provides that «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

[23] See, Declaration of Rajinder Sahota (CARB) Cross-Motion for Summary Judgement and Opposition, United States of America v. State of California, et Al., 68, par. 76, https://www.caed.uscourts.gov/caednew/assets/File/19cv2142%20Doc%2050.pdf (last visited Aug 21, 2023).

[24] Cabinet de la ministre du Développement durable, de l'Environnement et de la Lutte contre les changements climatiques, *Le marché du carbone : un outil reconnu qui couvre maintenant plus de 50 % du PIB mondial*, https://www.newswire.ca/content/newswire-ca/ca/fr/news-releases.detail.html/null.htm (last visited Aug 16, 2023).

[25] Newsrelease : California Air Resources Board, *Market Notice : New Functionnality in CITSS*, https://ww2.arb.ca.gov/sites/default/files/cap-and-trade/auction/marketnoticejune2018.pdf (last visited Aug 16, 2023).

period». In this instance, the end of the compliance period was December 31st, 2020.

The use of the term "shall endeavour" does not render these timelines obligatory and grants a large degree of flexibility to a Party wishing to withdraw. The following events show that this interpretation had clearly been adopted by the Premier-Designate.

Doug Ford took office as prime minister on June 29th, 2018, and despite the provisions of Article 17 of the 2017 Agreement, moved to immediately dismantle the cap-and-trade program. On July 3rd, 2018, his government repealed the program with immediate effect and prohibited transactions of emission rights between Ontario participants[26]. This decision formally terminated linkage with California and Québec, thereby establishing July 3rd, 2018, as the official date for the delinking of Ontario from the common market.

The government subsequently introduced Bill 4 on July 25, 2018, to wind down Ontario's cap-and-trade program. The Bill modified the existing compliance period, mandating capped participants to report their GHG emissions until July 3rd, 2018, and retire emission allowances corresponding to those emissions. Additionally, the Bill outlined a compensation process for capped participants with excess purchased allowances. However, the Bill explicitly denied compensation for uncapped market participants who had bought allowances during the common auctions or on the secondary market[27]. During the legislative debates, when asked to justify this exclusion, Rod Philipps, then Minister of the Environment, Conservation and Parks explained that this category of "(…) participants without a compliance obligation chose to take risks as market traders and speculators", equating market risks and regulatory risks[28].

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[26] Ontario, *O. Reg. 386/18: Prohibition Against the Purchase and Other Dealings with Emission Allowances and Credits*, (2018), https://www.ontario.ca/laws/view (last visited Aug 16, 2023).

[27] Art. 8 (5), Ontario, *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*, (2018), https://www.ola.org/en/legislative-business/bills/parliament-42/session-1/bill-4.

[28] See p. 486 of Legislative Assembly of Ontario, *Hansard, 31 July 2018 N°12*, (2018), https://www.ola.org/en/legislative-business/house-documents/parliament-42/session-1/2018-07-31/hansard (last visited Aug 16, 2023).

Significantly, Bill 4 incorporated a Crown Immunity Protection clause, shielding governmental actions from legal repercussions[29]. In explicit terms, Section 10(1) ensured that no cause of action could arise against the crown because of actions pertaining to the cancellation Act, the retirement, or annulment of any cap-and-trade instruments. This immunity extended comprehensively, proscribing any legal proceedings against the crown, including claims rooted in contract, tort, misfeasance, bad faith, trust, or fiduciary obligations.

To summarize, the withdrawal of Ontario from the WCI carbon market occurred within an 18-day timeframe, in stark contrast to the significantly longer timelines envisioned by article 17 of the 2017 linkage agreement. The swift and unilateral withdrawal by Ontario, albeit technically within the scope of the agreement's language, might not have been conforming to the original spirit and intent of the Parties.

3.2 Ensuing domestic and international litigation

Legal proceedings against the decisions of the Ontario government were promptly initiated, addressing both the government's obligations regarding public consultation and Bill 4's annulment of allowances without compensation.

On July 18th, 2018, the *Canadian Environmental Law Association* filed a petition for review against Regulation 386/18, citing failure to observe public consultation requirements as stipulated under the Environmental Bill of Rights[30]. Ecojustice, on behalf of Greenpeace Canada filed a similar challenge on September 11, 2018, targeting both Regulation 386/18 and Bill 4, over the absence of meaningful public consultations, in accordance with the Environmental Bill of Rights[31]. In reaction, a few hours

[29] Art. 9 and 10 of Ontario, cit. at 27.

[30] Canadian Environmental Law Association, *Application for Review to the Ministry of the Environment Conservation and Parks, Filed Pursuant to Section 61 of the Environmental Bill of Rights, Re: Ontario Regulation 386/18 Prohibition on the Purchase, Sale and Other Dealings with Emission Allowances and Credits*, (2018), https://cela.ca/wp-content/uploads/2019/07/EBR-Application-for-Review_cap-and-trade.pdf (last visited Aug 17, 2023) This petition was subsequently denied on September 21, 2018.

[31] Press release: *Environmental groups take Ontario to court for unlawfully cancelling cap and trade program*, Ecojustice (2018), https://ecojustice.ca/news/environmental-groups-take-ontario-to-court-for-unlawfully-cancelling-cap-and-trade-program/ (last visited Aug 17, 2023).

later, the Ontario government launched a 30 days public comment period over Bill 4[32]. On October 11th, 2018, while the majority of the court found that the cancellation of the cap-and-trade program without public consultation was unlawful, the case was dismissed on the grounds that a public consultation had in effect been conducted and that the law had been enacted[33].

While these legal actions delayed the adoption and implementation of Bill 4, they were unable to change the outcome especially for uncapped participants. As a result, two legal actions over Bill 4 cancellation of allowances without compensation were also initiated**.**

The first action was launched on December 7th, 2020, by Koch industries Inc. ("Koch"), a US based company. Its Canadian subsidiary Koch Supply & Trading LP ("KST") was a market participant under the Ontario cap-and-trade program and had purchased a large quantity of allowances on the primary and secondary markets. KST was not entitled to compensation under Bill 4, because it was a market participant. After several unsuccessful attempts to negotiate some form of compensation with the Ontario government, and because of the Crown immunity clause in the cancellation Act, Koch filed a request for arbitration against Canada pursuant to Chapter 11 of the North American Free Trade Agreement (NAFTA), seeking damages of approximately 30.000.000 USD[34].

The case raises several procedural questions related to chapter 11 of NAFTA and eligibility under the legacy clause. Of interest to our discussion are claims 1) that the 2017 Agreement created legitimate expectations for market participants in case of Ontario's delinking with WCI partners, and that 2) in cancelling

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[32] Environmental Registry of Ontario, *Comment Period on Bill 4, Cap and Trade Cancellation Act, 2018*, (2018), https://ero.ontario.ca/notice/013-3738 (last visited Aug 17, 2023); We're taking Premier Ford to court, ECOJUSTICE (2018), https://ecojustice.ca/news/taking-premier-ford-to-court/ (last visited Aug 17, 2023).

[33] Ontario Superior Court of Justice, Divisional Court, Greenpeace Canada v. Minister of the Environment, Conservation and Parks (Ontario), 2019 ONSC 5629, https://ecojustice.ca/wp-content/uploads/2019/10/Greenpeace-v-Min.-Environment-20191011.pdf.

[34] ICSID, *Koch Industries Inc. & Koch Supply & Trading, LP v. Canada, Request for Arbitration*, http://icsidfiles.worldbank.org/icsid/ICSIDBLOBS/OnlineAwards/C9375/DS17196_En.pdf (last visited Aug 17, 2023).

allowances without compensation, the government of Ontario unlawfully expropriated Koch's property rights[35]. At of the time of writing, the hearings have taken place, but the decision is still pending.

A second action was launched by SVM Energy Solutions ("SVM"), another market participant in the Ontario Cap and Trade program, which found itself ineligible for compensation under Bill 4. On February 19th, 2021, SVM sought leave to initiate a class action against the Government of Ontario, pursuing both general and punitive damages, as well as a formal declaration that the July 3rd regulation and Bill 4 were in violation of the 2017 Agreement[36].

The case raises several procedural questions related to class action proceedings and the constitutionality of the Crown immunity clause. Central to our discussion is the question of whether the way California, Québec, and Ontario framed the 2017 Agreement created legitimate expectations among market participants. Specifically, whether it led them to anticipate that the termination of the Ontario cap-and-trade program would be executed in a in a manner to minimize avoidable, harmful economic impacts to them. As of the time of writing, the proceedings are still ongoing[37].

These proceedings illustrate the limitations of the cooperation model deployed within the WCI framework and allow for certain lessons to be drawn.

4. Lessons learned from Ontario's withdrawal

The Western Climate Initiative (WCI) represents an ambitious experiment in transantional collaboration despite serious political and regulatory challenges. Yet, its structure faces legal ambiguities and governance concerns that pose potential risks to the common carbon market. This section explores these complexities, highlighting the resilience (4.1) and vulnerabilities of the WCI's cooperative effort (4.2).

[35] *Id.* at 6 par. 36.

[36] Ontario Superior Court of Justice, *SMV Energy Solutions v. Minister of the Environment, Conservation and Parks (Ontario), Statement of Claim*, (2021), https://cbaapps.org/ClassAction/PDF.aspx?id=18937 (last visited Aug 17, 2023).

[37] *Id.* at 31.

4.1. WCI as a resilient and flexible cooperative model

The Western Climate Initiative (WCI) offers a flexible cooperative model that allowed Québec and California to develop a transborder carbon market, even when faced with federal hostility[38]. The model's adaptability to geopolitical complexities underscores the feasibility of transnational collaboration of subnational governments, and is exemplified by the stability of the market, even amid the sudden withdrawal of Ontario.

The model is specifically tailored to its partners' unique needs and constitutional limitations, and facilitates transnational cooperation through WCI Inc. This includes instances where carbon markets were not linked, such as California, Québec and Ontario before linkage, and at the time of writing Nova Scotia, and Washington State[39]. However, the reliance on American private entities to perform certain administrative, technological, and financial functions has its drawbacks, as it muddles the governance structure of the carbon market and raises questions related to transparency, compliance, and accountability.

Since its inception, WCI seemed to be particularly well adapted to foreseeable and ongoing regulatory transformations. As stated earlier, these transformations have been structured around waves. To that effect, the 2013 and 2017 Agreements contain dispositions providing for prior consultations between partners before regulatory transformation[40]. However, this aspiration has faltered in practice, and California tends to modify its cap-and-program without prior consultation with Québec[41]. Consequently,

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[38] For a description of the federal context in the USA and Canada see A. Chaloux (ed.), *L'action Environnementale Au Québec: Entre Local et Mondial* (2017), http://ebookcentral.proquest.com/lib/uqam/detail.action?docID=4891437 (last visited Aug 15, 2023).

[39] Following its victory in the 2021 provincial elections, the Progressive conservative party announced an orderly wound-up of the cap-and-trade program. The program will end in december 2023, see International Carbon Action Partnership, cit. at 2; The Washington's cap-and-invest program began operating in January 2023, see International Carbon Action Partnership, cit. at 2.

[40] For exemple art. 4 provides that a «(...) Party may consider making changes to its respective programs (...) [and that] any changes or additions (...) shall be discussed between the Parties." Moreover, the "(...) Parties shall consult regarding changes (...) that my have impacts on any parties», California, Ontario, & Québec, cit. at 6.

[41] California has modified its cap-and-trade regulations more that five times since linkage with Québec and has done so without consulting the province see p. 68,

Québec finds itself in a position of ensuring its program's continuing alignment with California's changes, indicating a more unilateral, rather than collaborative, approach.

The size discrepancy between California's and Québec's programs may explain this imbalance, but it also brings forth concerns about Québec's constrained choices in maintaining its cap-and-program. This asymmetry raises critical questions about the scalability of the WCI model, including its capacity to accommodate additional partners and to manage disagreements between them regarding regulatory transformations. The existing framework, as it stands, seems ill-equipped to handle such complexities and tensions, thus potentially undermining the stability and future expansion of the WCI.

This is why, despite its apparent resilience, the model structural robustness might be called into question in the face of regulatory risks.

4.2. WCI as a model which amplifies regulatory risk

It might be argued that the WCI cooperative model has a reduced ability to handle unforeseen transformation of domestic law and amplifies the effects of regulatory risks on common carbon market participants. These drawbacks arise partly from the ambiguous nature and effectivity of the 2013 and 2017 agreements.

Ontario's conduct in 2018 during its withdrawal from the WCI deemed the 2017 Agreement as non-binding and defeated the indications given about how WCI Partners would interact with each other with respect to regulatory change. The ambiguity surrounding the agreement was further underscored when, in October 2019, the Trump Administration questioned its constitutionality in front of the United States District Court of the Eastern District of California[42].

In this case, the Trump Administration contested the validity of the linking arrangements between California and Québec's cap-

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par-78-83, Declaration of Rajinder Sahota Cross-Motion for Summary Judgement and Opposition, cit. at 23.

[42] Documents of that case may be consulted at United States District Court, Eastern District of California, *Cases of Interest: USA v. State of California, et al. (Climate Initiative)*, https://www.caed.uscourts.gov/caednew/index.cfm/clerks-office/cases-of-interest/219-cv-2142-usa-v-state-of-california-et-al-climate-initiative/ (last visited Aug 22, 2023).

and-trade programs, specifically the 2017 Agreement, alleging that it violated the U.S. Constitution's treaty clause, compact clause, and Foreign Affair doctrine. Several issues were up for debate, but at the heart of the discussion was the nature of the 2017 Agreement. If it was deemed a treaty under U.S. constitutional law and its provisions were binding, then California would have infringed on powers belonging to the federal government.

California pleaded Ontario's disregard of the 2017 Agreement as evidence that it was non-binding, and as mentioned earlier, asserted that despite the language of the Agreement, it had never consulted Québec prior to altering its cap-and-trade program. The court sided with California and ruled that, although in «(…) its current form, California's cap-and-trade program has extended beyond an area of traditional state competence by creating an international carbon market», the 2017 Agreement does not constitute a treaty as defined by the U.S. Constitution and its provisions are not binding[43].

Interestingly, California's arguments are now invoked by Canada in the Koch case as proof that Ontario had made no commitments under the 2017 Agreement[44]. However, these positions should be interpreted considering their contexts. Canada likely asserts the non-binding nature of the Agreement to dodge responsibilities under NAFTA, while California may have argued similarly to shield the Québec linkage from the Trump administration's attack.

However, Québec position might differ. While this article steers clear of Québec-Canada constitutional disputes, it is important to mention that Québec's approach to international agreements, particularly in the field of environmental and natural resources, is anchored in the Gerin-Lajoie doctrine. This doctrine

[43] W.B. Shubb, United States v. California, et Al. 444 F. Supp. 3d 1181 (E.D. Cal. 2020) (2020) The judgment was appealed by the Trump administration on September 15, 2020. However, the appeal was subsequently abandoned by the Biden administration on March 22, 2021, and the case did not progress to the Court of Appeal.

[44] ICSID, *Koch Industries Inc. & Koch Supply & Trading, LP v. Canada, Counter-Memorial on Jurisdiction and the Merits*, 97, http://icsidfiles.worldbank.org/icsid/ICSIDBLOBS/OnlineAwards/C9375/DS17715_En.pdf (last visited Aug 23, 2023).

asserts Québec's ability to negotiate and sign international accords within its constitutional jurisdiction[45].

This explains why the Québec ministry of international relations differentiates the 2013 and 2017 Agreements from ordinary memorandums or political statements, categorizing them as "International Agreements", thereby considering them legally binding[46]. This stance is exemplified by the 2013 Agreement, which secured the unanimous approval of the Québec National Assembly.

However, the legitimacy of the Gérin-Lajoie doctrine remains disputed within Canadian constitutional Law and its practical impact is limited[47]. For example, Québec did not formally object to Ontario's disrespect of the provisions of the 2017 agreement and Québec classification of the 2013 and 2017 agreements has not been argued by the parties in the USA v. California and the Koch v. Canada cases.

The uncertainty surrounding the 2017 Agreement's effectivity has also negative consequences on the legitimate anticipations formed by market participants. The Koch and SVM cases reveal that market actors shared understanding was that the Ontario cap-and-trade program termination was a possibility. They nevertheless expected the province adherence to the withdrawal procedure set out in art. 17 of the 2017 Agreement. To that effect, there was a widespread assumption that Ontario would participate in the August 2018 common auction, and that any termination would align with the end of the compliance period in December 2020, or at the very least, that Ontario would give a 12-month notice before withdrawing from the WCI. In addition, stakeholders anticipated that Ontario would actively collaborate with Québec and California to clarify the status of Ontario's emission rights

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[45] D. Turp, *L'approbation des engagements internationaux importants du Québec : la nouvelle dimension parlementaire à la doctrine Gérin-Lajoie*, RQDI 9 (2020).

[46] For a description of Québec's official position on international agreements see Agreements and commitments, Gouvernement du Québec, https://www.quebec.ca/en/government/agreements-and-commitments (last visited Aug 22, 2023).

[47] For further discussion of this issue in the context of the WCI, see D.V. Wright, cit. at 1; A. Messing, *Nonbinding Subnational International Agreements: A Landscape Defined Notes*, 30 Geo. Envtl. L. Rev. 173 (2017); F. Roch & J. Papy, cit. at 1.

within the common market and the particulars of holdings in participant accounts[48].

These beliefs illustrate a pervasive misunderstanding of the legal framework governing WCI linkage, particularly the 2017 Agreement's role and essence. For example, SVM, Koch as well as the US government have argued that the agreement had an actual legal effect on the linking process and common carbon market framework[49]. This misapprehension led market participants to a flawed perception of diminished regulatory uncertainty around which they build erroneous expectations.

These beliefs also show that the structure of linkage arrangements allows the regulatory risks of each WCI partner to be transferred to the common carbon market. This leads to greater uncertainty and higher transaction costs for market participants who have to monitor political and legal developments in each partner's jurisdiction. For example, had the court sided with the U.S. government in the U.S. v California case, the linkage with Québec could have been disrupted, leading to negative consequences for Québec participants, such as an increase in allowance prices. Furthermore, Québec cap-and-trade program is subject to an annual equivalency review by the Canadian federal government in relation to the federal carbon tax. Should the equivalency be lost, the viability of Québec cap-and-trade program might be called into question[50].

Risks to the common market may also arise from unresolved legal questions within partners' regulations, such as the legal nature of emission rights. The Ontario government refusal to indemnify market participants highlights this question. For example, Koch argues that the Ontario government decision amounted to an

[48] ICSID, *Koch Industries Inc. & Koch Supply & Trading, LP v. Canada, Memorial on Jurisdiction and the Merits*, 53, 106, http://icsidfiles.worldbank.org/icsid/ICSIDBLOBS/OnlineAwards/C9375/DS17197_En.pdf (last visited Aug 23, 2023); Ontario Superior Court of Justice, cit. at 36, 31.

[49] Ontario Superior Court of Justice, cit. at 36, 23; ICSID, cit. at 48, 116; United States District Court, Eastern District of California, United States of America v. State of California, et al., Complaint 8, https://www.caed.uscourts.gov/caednew/assets/File/19cv2142%20Doc%201.pdf (last visited Aug 23, 2023).

[50] Mémoire de l'intervenante la Procureure Générale du Québec, Supreme Court of Canada, References re Greenhouse Gas Pollution Pricing Act, 75.

unlawful taking of property[51]. On the other hand, in the Koch case, Canada quotes California and Ontario regulations to argue that emission rights are mere revocable administrative authorization to emit and that their revocation cannot trigger indemnification[52].

This is another example where the situation in Québec might differ. Québec has no such qualification in its cap-and-trade regulation. Because its legal system is based on both common and civil law, the qualification of emission rights under Québec law might be closer to what is found in many continental European countries with respect to EU-ETS allowances and be considered property. This potential fragmentation in the classification of emission rights may lead to legal uncertainties reminiscent of those encountered within the European Emissions Trading System.[53] In this context, the forthcoming arbitration decision in the Koch v. Canada case could have far reaching consequences.

5. Conclusion

The withdrawal of Ontario was the strongest resiliency test of the WCI linkage model and offers critical insight into the WCI transnational cooperative model.

The 2017 Agreement could have diminished regulatory ambiguity for stakeholders and clarified the rules of conduct for WCI partners, especially regarding linkage. However, Ontario's withdrawal underscores its failure to meet these objectives, undermining the model's credibility. Furthermore, the Agreement's drafting gave a false sense of security to market participants and might have contributed to the losses which they incurred.

Conversely, Ontario's departure underscored the model's resilience. California and Québec quick response to Ontario's actions effectively mitigated market disruptions and preserved the integrity of their individual programs. Nevertheless, the model's scalability and aptitude for broader multi-jurisdictional engagement remains in question.

Finally, Ontario's exit underscores the importance of negotiating from the outset, clear and enforceable market linkage

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[51] ICSID, cit. at 48, 94, 117.
[52] ICSID, cit. at 44, 6, 49.
[53] See observations 25 to 28 expressing concerns related to the definition of allowances of European Court of Auditors, *Special Report No 6/2015: The Integrity and Implementation of the EU ETS*.

termination provisions and timelines. These procedural elements could be both coordinated and integrated within the regulations of the various cap-and-trade programs. Furthermore, the formulation of compensatory mechanisms for market participants is essential, especially for mitigating unpredictable regulatory risks. Regulatory frameworks could stipulate conditions under which indemnification is triggered, for example when established procedural obligations are breached. In this context, Contracts for Differences could be useful instruments and might merit further exploration.