# Canada Finalizes Clean Fuel Regulations



On July 6, 2022, Canada released the final version of the long-awaited *Clean Fuel Regulations* (CFR or Regulations). The CFR *will* require producers and importers of liquid fossil fuels, such as gasoline and diesel, to gradually reduce the carbon intensity (CI) of these fuels beginning in December 2023. The federal government expects these reductions will result in a 15% decrease in the CI of liquid fuels below 2016 levels by 2030. Annual CI reduction requirements can be satisfied in a variety of ways, including through a newly established credit market.

This bulletin highlights the compliance credit aspects of the CFR, opportunities for involvement in the credit market and potential interactions between the CFR and provincial renewable fuels regimes.

## BACKGROUND

The CFR was initially proposed as part of the Pan-Canadian Framework on Clean Growth and Climate Change in 2016. Following consultations with affected stakeholders, the draft CFR was released in December 2020. Release of the final Regulations was initially targeted for December 2021. The federal government announced the release of the final CFR on June 29, 2022, and the CFR was published in the *Canada Gazette* on July 6, 2022.

Certain components of the CFR are currently in force, including registration requirements, applications for approval of CI for fuels and applications for the recognition of emission reduction projects and compliance credit creation. Other components of the CFR will come into force in the future. Most significantly, the obligation to achieve prescribed CI reduction requirements does not come into force until July 1, 2023.

## OVERVIEW

The Regulations have been enacted under the *Canadian Environmental Protection Act, 1999 and replace the current federal Renewable Fuels Regulation.* The purpose of the CFR is to reduce the CI of liquid fossil fuels used in Canada by approximately 15% below 2016 levels by 2030. Carbon intensity is measured in grams of carbon dioxide equivalent per megajoule of energy contained in the fuel (gCO2e/MJ) and defined as the amount of carbon dioxide equivalent emissions released over the lifecycle of the fuel, including extraction, refining or processing, distribution, and end use.

The producers and importers of liquid fossil fuels (defined as "primary suppliers") are required to reduce the CI of their fuels from a prescribed baseline to the annual CI limit. The CI limit is lowered each year between 2023 and 2030. Primary suppliers can comply with the Regulations in multiple ways:

- **Compliance Category 1:** Undertake projects that reduce the lifecycle CI of fossil fuels (e.g., use of renewable electricity at production facilities, carbon capture and storage, co-processing of fuels, etc.)
- **Compliance Category 2:** Supply the Canadian market with low carbon fuels, such as ethanol and biodiesel.
- **Compliance Category 3:** Supply fuel or energy to advanced vehicle technology (e.g., electricity or hydrogen for use in vehicles).

Primary suppliers can create compliance credits by undertaking activities in any of these categories or purchase credits created by other participants in the CFR credit market, referred to in the Regulations as “registered creators.”

Compliance may also be achieved through contributions to a registered emission-reduction funding program. The compliance credit price under the funding program is set at C$350 in 2022 and will be adjusted based on the consumer price index (CPI). Primary suppliers may rely only on contributions to the compliance fund for up to 10% of their annual CI reduction obligation.

## CFR CREDIT MARKET

The Regulations establish a credit market wherein each credit represents a lifecycle emission reduction of one tonne of carbon dioxide equivalent. For each compliance period (typically a calendar year), primary suppliers must demonstrate compliance with CI reduction requirements for the fuels they produce or import by either creating or acquiring credits and then using the required number of credits toward its compliance obligation.

Credits may be acquired through direct trading with other market participants or through a credit clearing mechanism. The credit clearing mechanism can be used only if a primary supplier is not able to satisfy its obligations by using credits it has created or acquired through direct trading. The Regulations set a maximum price for credits acquired, purchased or transferred in the compliance credit clearance mechanism at C$300 in 2022 (CPI adjusted). If the credit clearance mechanism does not have sufficient credits to satisfy all primary suppliers’ outstanding obligations, each primary supplier will be eligible to acquire a prorated amount of the available credits.

Compliance credits will be registered and traded via the

Credit and Tracking System (CATS). CATS is currently used by participants in the federal Output-Based Pricing System and GHG Offset Credit System, which are discussed in our December 2018 *Blakes Bulletin: Federal Carbon Pricing System Coming Into Force January 2019: How Will it Impact Your Business'* and our June 2022 *Blakes Bulletin: Canada's Greenhouse Gas Offset Credit Regulations: Now in Force*. The CATS platform will also be used by primary suppliers, registered creators and verification bodies to perform functions such as registration, applying for approval of CI, managing credit creation and credit transactions, and complying with periodic reporting requirements.

The federal government anticipates that the demand for CFR compliance credits will create a market signal for investment in low CI fuels and projects that fit within the CFR compliance categories. In fact, the CFR expressly contemplates participation by voluntary credit creators. Voluntary credit creators can participate directly in the credit market by becoming registered creators and obtaining a CATS account or by entering into an agreement with a registered creator pursuant to section 21 of the Regulations.

## INTERACTION WITH PROVINCIAL REGIMES

The CFR follows an approach to low carbon fuel regulations in other jurisdictions, including California, Oregon and British Columbia. For example, the British Columbia *Renewable and Low Carbon Fuel Requirements Regulation* (RLCFRR) sets minimum standards for renewable fuel content in the province and prescribes a progressive annual reduction in the CI of fuels that aims to reduce the CI of fuels by 20% below 2010 levels by 2030. The British Columbia regime also allows regulated entities to generate or acquire credits for the purposes of achieving their reduction requirements.

The B.C. government recently introduced Bill 15, which, if passed, will replace the RLCFRR with the *Low Carbon Fuels Act*

(LCFA). The LCFA will largely maintain the current regime but will likely be expanded to include marine and aviation fuels and permit compliance credits to be issued for sequestering eligible greenhouse gases.

Considering the alignment between these regimes, some have questioned whether credits generated under the B.C. RLCFRR (or other provincial regimes) could be used for the purposes of CFR compliance or vice versa. The Regulatory Impact Analysis Statement (RAIS) that accompanies the CFR confirms that the dual use of credits is possible but will ultimately be a matter for provincial regulators to decide. Specifically, the RAIS confirms that: "All low CI fuels supplied to the Canadian market, including fuels used to comply with existing federal and provincial renewable fuel regulatory requirements and British Columbia's RLCFRR, are able to create credits under the Regulations." It further confirms that: "The Regulations allow for credit creation opportunities, even if a given project generates credits in another program (e.g. federal or provincial offset programs). However, it is important to note different programs may decide not to provide credits for the same actions."

Stakeholders are encouraged to consult with relevant provincial government agencies to confirm whether dual use of compliance credits is possible. We are hopeful that provincial agencies will release formal policy statements regarding this issue in the near term to assist primary suppliers and others seeking to participate in the CFR credit market.

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*The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.*

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