Emissions Cap: Government Of Canada Introduces Draft Regulations For Oil And Gas

Introduction

On November 4, 2024, the Government of Canada released proposed regulations under the *Canadian Environmental Protection Act, 1999* (CEPA) that, if adopted, will impose a cap on greenhouse gas (GHG) emissions from the upstream oil and gas sector and the LNG sector (Emissions Cap Regulations). The proposed Emissions Cap Regulations, which follow the Regulatory Framework to Cap Oil and Gas Sector GHG Emissions initially introduced by the federal government in December 2023, propose a cap-and-trade system aimed at reducing emissions from the oil and gas sector to 35% below 2019 levels by 2030-2032.

The federal government states that the proposed Emissions Cap will incentivize the oil and gas sector to invest in decarbonization strategies to attain significant emissions reductions and that the cap includes sufficient flexibility to enable continued production growth in the sector.

Background

The proposed Emissions Cap Regulations would establish a national cap-and-trade system for prescribed activities, which

include onshore and offshore oil and gas production, oil sands production and upgrading, natural gas production and processing, and the production of LNG. They would cap GHG emissions from certain activities and prohibit the emission of GHGs from any of the prescribed industrial activities unless the operator registers by submitting the required information to the federal Minister of the Environment (Minister).

Operators of all existing prescribed oil and gas facilities would be required to register prior to January 1, 2026. Any operators that do not register by that date would be prohibited from emitting GHGs from their industrial activities unless and until registration is completed. The proposed Emissions Cap Regulations differentiate between "covered operators" and all other operators with respect to reporting and remittance obligations. Beginning in 2030, operators classified as "covered operators" – those producing at least 365,000 barrels of oil equivalent per year – would be required to offset their GHG emissions from industrial activities by remitting eligible compliance units under the proposed cap-and-trade system.

The Emissions Cap will be established based upon GHG emissions data reported by oil and gas sector operators in 2026. The Emissions Cap for a facility for the 2030-2032 compliance period will be set at 73% of the emissions reported for 2026 (which has been estimated to be equivalent to 35% below 2019 emissions levels). The Emissions Cap is expected to decrease over time to reflect future changes in production and emissions levels.

For purposes of the Emissions Cap Regulations, GHG emissions are attributed to a facility determined in accordance with the Quantification Methods for the Oil and Gas Sector Greenhouse Gas Emissions Cap Regulations (Quantification Methods), on which the government is also seeking feedback. The Quantification Methods, which will apply beginning in 2026, will define the methods used to calculate each source of

emissions while also providing specific default values for global warming potential. The calculation for attributed GHG emissions will take into consideration emissions from all emissions sources at the facility, excluding electricity generation and permanently stored carbon dioxide (CO_2). Indirect emissions from thermal energy and hydrogen produced on site or supplied to the facility will also be excluded.

Eligible compliance units include emission allowances, decarbonization units and offset credits, which are described as follows:

- **Emission allowances** will be distributed to covered operators on an annual basis up to the level of the facility-specific Emissions Cap for that year. At least 80% of the compliance units must be comprised of emission allowances. The allowances will be distributed amongst covered operators based on their historical production and the specified distribution rate for the industrial activities in which they are involved.
- **Decarbonization units** (which may be used for up to 10% of a covered operator's remittance obligations) are obtained by contributing to a decarbonization program that will be used to fund projects supporting the reduction of GHG emissions from the oil and gas sector.
- **Offset credits** (which may be used for up to 20% of a covered operator's remittance obligations) are those issued pursuant to the Canadian Greenhouse Gas Offset Credit System Regulations and provincial offset credits recognized for use under the Output-Based Pricing System Regulations (i.e., offset credits recognized under the Greenhouse Gas Pollution Pricing Act – see our June 2022 *Blakes Bulletin: Canada's Greenhouse Gas Offset Credit Regulations: Now in Force* for additional information).

Key Takeaways

Under the proposed Emissions Cap Regulations:

- The cap-and-trade system will freely allocate emissions allowances to covered operators for each of their covered facilities in an amount equal to 73% of their 2026 GHG emissions.
- Emissions allowances are transferable between operators.
- Decarbonization units are not transferrable.
- The cap-and-trade system would allow for "cross-recognition" of offset credits to meet remittance obligations under the draft Regulations as well as coinciding obligations under federal or provincial carbon pricing regimes. Environment and Climate Change Canada (ECCC) is expected to establish a list of carbon pricing systems where cross-recognition is authorized. Cross-recognition at the federal level would be operationalized through amendments to the *Output-Based Pricing System Regulations*. Cross-recognition at the provincial level would depend on a province making any necessary adjustments to their carbon pricing regime and entering into a recognition agreement with the Minister.

Compliance Periods

Compliance periods are each three calendar years, with the first compliance period spanning January 1, 2030, to December 31, 2032. Covered operators would be required to remit one compliance unit for each tonne of GHGs that their facilities emit during the compliance period by no later than January 31 of the year that is thirteen months after the end of a compliance period.

Covered operators would also be subject to an interim requirement to remit compliance units equivalent to at least 30% of attributed GHGs during the first and second years of the compliance period.

Reporting

The Emissions Cap and cap-and-trade system will be phased in over a four-year period from 2026-2029. During this period, operators must report their emissions and production levels and submit verified annual reports to ECCC every calendar year. Under the draft regulations, large operators (operators who otherwise reported their emissions to a Canadian energy regulator and had a total monthly cumulative production during any of the months between January 2024 and June 2025, equal to or above 30,000 barrels of oil equivalent, or those subject to reporting their GHG emissions in 2024 under a subsection 46(1) CEPA notice) will begin reporting in 2027 based on their 2026 emissions and production levels. Small operators (operators that do not meet the criteria for large operators) will begin reporting in 2029 for their 2028 emissions and production levels.

Annual reporting requirements involve two separate reports. One report is required for each reporting facility and a second report is required that describes the cumulative production of an operator based upon all of its facilities.

After the first reporting period, all operators will be required to continue to report for each calendar year in which GHGs are emitted as a result of an industrial activity carried out at their facility. ECCC will use reports to identify the covered operators that are subject to the Emissions Cap and associated emission allowance remittance obligations.

Looking Ahead

The Emissions Cap adds to the list of several regulatory measures that have been implemented or proposed by the federal government with the intent of shifting towards reduced emissions, including the Output-Based Pricing System under the *Greenhouse Gas Pollution Pricing Act*, *Clean Fuel Regulations*, the proposed *Release of Methane Emissions*

Regulations and the *Clean Electricity Regulations* among other measures. For a detailed discussion of the previous regulatory measures mentioned above, please see our March 2021 *Blakes Bulletin: Now That the Greenhouse Gas Pollution Pricing Act Has Been Determined to be Constitutionally Valid – What Does it All Mean?*, our July 2022 *Blakes Bulletin: Canada Finalizes Clean Fuel Regulation*, and our August 2023 *Blakes Bulletin: Canada Seeks Input on Draft Clean Electricity Regulations*.

The backgrounder accompanying the proposed Emissions Cap Regulations suggests that the Emissions Cap reflects technically achievable reductions based on the federal government's assessment of abatement technologies that can, in the federal government's view, be feasibly deployed within the oil and gas sector by 2030-2032. While it remains to be seen whether the Emissions Cap can be achieved through the deployment of abatement technologies, the proposed Emissions Cap Regulations will add another layer of complexity to emission reduction obligations in the oil and gas sector.

The proposed Emissions Cap Regulations are open for public comment from November 9, 2024, to January 8, 2025. The federal government anticipates publishing final regulations later in 2025.

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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