Federal Government Publishes New Cap-and-Trade Framework for Oil and Gas Sector GHG Emissions

It’s finally here. On December 7, 2023, the federal government published the long-awaited rules setting out a framework (the “Framework”) for a cap-and-trade system designed to limit 2030 oil and gas sector emissions to 20 to 23% below 2019 levels. Here’s a briefing on the 6 things you need to know about the Framework.

1. What It Covers

The cap-and-trade system covers greenhouse gas (GHG) emissions from liquified natural gas (LNG) and upstream conventional oil, offshore, oil sands and natural gas production and processing facilities responsible for 85% of all sector emissions in 2021. It also accounts for transfers of thermal energy, hydrogen carbon dioxide (CO2), and electricity, requiring each covered facility to report and quantify information related to the purchase and sale, production, use and import, and export of thermal energy, hydrogen and electricity, as well as CO2 transfers for storage. Such accounting would ensure a level playing field and minimize leakage risk—in particular, by minimizing the incentive for covered facilities to relocate energy production (and any associated emissions) outside of the cap. Unlike the regulatory systems of some provinces and US states, the Framework doesn’t allow for facilities to be exempt provided that their annual emissions threshold fall below a stated level.

2. How It Works

The Framework would function like a typical cap-and-trade system with emission caps and allowances. Covered facilities would be allowed to emit a tonne of carbon dioxide equivalent (CO2e) equal to the cap allocated to covered facilities within the sector. Facilities may trade their allowances with other covered facilities, creating an incentive to minimize their emissions. During each compliance period, facilities will have the flexibility either to retire allowances equal to their emissions during that period or “true up” allowance shortfalls by purchasing and retiring other eligible compliance instruments, up to certain limits.

3. The Emissions Caps

Starting in 2030, there will be cap in the range of 106 to 112 mega tonnes (MT) of GHG emissions (as opposed to the 171 MT permitted in 2019). However, companies will be able to use tradable allowances, federally-recognized offset credits, decarbonization fund units, internationally transferred mitigation outcomes (ITMOs) and other compliance instruments to gain the right to emit between 131 and 137 MT per year.

4. How Allowances Will Be Allocated

Allowances will initially be allocated to covered facilities for free based on their performance in producing the same or similar products with lower emission intensity. The government may also hold auctions where facilities can purchase additional allowances.

5. The Compliance Dynamics

To smooth the transition, companies will be subject to a series of 3-year compliance periods that include both an annual requirement and a final true-up at the end of the period. Facilities that can’t meet their emissions targets with the allowances they’re allocated will have to buy and retire allowances from other facilities with a surplus or rely on other compliance instruments. Options the government is considering include:

- **Decarbonization funding:** Contributions to a decarbonization fund covering up to 10% of emissions purchased at a price per fund unit set at the estimated allowance price needed for the sector to reduce GHG emissions, subject to an upper limit;
- **Offset credits:** Retiring offset credits awarded to projects or activities that voluntarily reduce greenhouse gas emissions beyond a business-as-usual baseline to cover a portion of their emissions; and/or
- **ITMOs:** Created under the Paris Agreement, ITMOs are internationally transferrable GHG mitigation outcomes.

Covered facilities will also be allowed to bank their unused allowances for up to 2 compliance periods. However, the government may establish limits on total allowances banked.

6. When the Framework Will Take Effect

Unless it’s extended, the deadline to comment on the newly proposed Framework is February 4, 2024. The government will then have to publish proposed regulations in the *Canada Gazette* for a 60-day public comment period. The plan is for the Framework to take effect in 2025. That means facilities will have to register by the end of 2025 or before emitting GHGs after January 1, 2026. Annual reporting will become mandatory in 2026.