Canada's Proposed Oil and Gas Sector Emissions Cap

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On November 4, 2024, the Government of Canada published a draft of the proposed ***Oil and Gas Sector Greenhouse Gas Emissions Cap Regulations*** (the **Proposed Regulations**). The Proposed Regulations would cap emissions from a range of industrial activities in the oil and gas sector, establish a cap-and-trade system for emissions allowances, and require facility operators to comply with various reporting and remittance obligations. The federal government states that the Proposed Regulations are intended to promote the development and uptake of decarbonization technologies while maintaining production growth. Many industry participants, as well as the Government of Alberta, anticipate that the Proposed Regulations will have a chilling effect on investor confidence, suppress spending on decarbonization initiatives and lead to production cuts.

The final version of the Proposed Regulations is expected to be published in mid-2025 and come into force by January 1, 2026. Stakeholders have been invited to **submit written comments** on the Proposed Regulations to Environment and Climate Change Canada by January 8, 2025.

Background

As part of its **2030 Emissions Reduction Plan**, which sets out a sector-by-sector roadmap for Canada to meet its emissions reduction goals, the Government of Canada committed to capping oil and gas emissions at a scale and rate necessary for the sector to reach net-zero emissions by 2050. The Proposed Regulations would establish an emissions cap at 27% below 2026 reported emissions levels, which is expected to equate to 35% below 2019 levels. It is anticipated that the emissions cap will reduce over time.

Registration and Reporting

The Proposed Regulations would apply to all operators of an oil and gas facility that carries out certain prescribed industrial activities, including conventional oil production, oil sands extraction and upgrading, natural gas production and processing, and liquified natural gas production. Every operator of a facility captured by the Proposed Regulations would be required to register under the scheme prior to January 1, 2026.

All operators captured by the Proposed Regulations would be required to submit two types of reports to the Minister of Environment and Climate Change (the **Minister**) each calendar year: (1) a "Cumulative Production Report", which must be submitted by an operator each calendar year describing all of the facilities it operates and its total production across all facilities in that year; and (2) an "Annual Report", which must be submitted by an operator for each facility or 'deemed facility'[1] it operates setting out the quantity of production at the facility and the quantity of GHGs attributed to the facility, calculated in accordance with prescribed **quantification methods**.

Operators with cumulative production greater than 30,000 barrels of oil equivalent (**BOE**) during any month between January 1, 2024 and July 1, 2025 would be required to submit their first reports by June 1, 2027 for the 2026 calendar year. Operators with monthly production less than 30,000 BOE would be required to submit their first reports by June 1, 2029 for the 2028 calendar year.

Covered Operators and Compliance Units

While registration and reporting requirements would apply to all operators, remittance obligations would only apply to operators with annual production greater than 365,000 BOE (**Covered Operators**). Covered Operators would be required to remit one compliance unit per carbon dioxide equivalent (**CO_2e**) tonne of their emissions. There are three categories of compliance units eligible for remittance under the Proposed Regulations:

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[1] Under the Proposed Regulations, multiple facilities may be deemed as a single facility for the purposes of reporting if certain prescribed conditions are satisfied.

Emissions Allowances

Each year, the Minister would allocate emissions allowances to Covered Operators based on a rolling average of historical production at their facilities and a prescribed distribution rate for the applicable industrial activity carried out the facility. Emissions allowances would be pro-rated across all Covered Operators such that the total number of emissions allowances allocated would equal the emissions cap.

Emissions allowances would be transferable between operators. There would be no limit on the number of emissions allowances a Covered Operator could hold, though emissions allowances would expire after a certain period. The Proposed Regulations require at least 80% of the compliance units remitted by a Covered Operator to be emissions allowances. Covered Operators may satisfy the remaining 20% through a combination of eligible offset credits or decarbonization units.

Eligible Offset Credits

Covered Operators would be permitted to satisfy up to 20% of their remittance obligations through eligible offset credits. Only offset credits issued under the *Canadian Offset Credit System Regulations*[2] and provincial offset credits recognized under the federal *Out-put Based Pricing System Regulations* (**OBPS**)[3] would be eligible for remittance under the Proposed Regulations.

While many details remain outstanding, the federal government has proposed amendments to the OBPS which would enable Covered Operators to use the same offset credits to satisfy coinciding obligations under the Proposed Regulations and authorized offset credit systems if certain conditions are satisfied. Notably, provincial offset credits would only be authorized for cross-recognition under the Proposed Regulations once the applicable province entered into an agreement with the federal Department of Environment, meaning some provincial offset credits could be authorized for cross-recognition while others are not.

Decarbonization Units

Covered Operators may purchase decarbonization units to satisfy up to 10% of their remittance obligations. To obtain decarbonization units, Covered Operators would need to make a contribution to a decarbonization program established under the Proposed Regulations at a rate of $50.00 per CO_2e tonne. Decarbonization units would not be tradeable and would only be eligible for remittance by the Covered Operator that acquired them during the compliance period in which they were purchased.

Remittance Obligations and Compliance Periods

Remittance obligations are organized by consecutive three-year compliance periods, with the first compliance period set to begin on January 1, 2030 and end on December 31, 2032. Covered Operators would be subject to interim remittance obligations during the first and second years of a compliance period equal to at least 30% of their emissions for each such year, within 25 months of the end of the applicable year. A final remittance obligation covering the entire three-year compliance period, adjusted for those compliance units already remitted for the first and second year of the compliance period, would be due within 25 months from the end of the three-year compliance period.

Enforcement

Covered operators who fail to comply with their remittance obligations would be prohibited from emitting any GHGs from any of the prescribed industrial activities carried out at their facilities until they have remitted the outstanding amount of compliance units. Further, any operator, not just Covered Operators, could face fines between $25,000.00 and $12,000,000.00 if they are found to have contravened certain provisions of the Proposed Regulations, though there is significant ambiguity on this point.

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[2] *Canadian Greenhouse Offset Credit System Regulations,* SOR/2022-111.
[3] *Output-Based Pricing System Regulations,* SOR/2019-266.

The federal government has indicated that it also intends to amend the *Regulations Designating Regulatory Provisions for Purposes of Enforcement (Canadian Environmental Protection Act, 1999)*[4] (the **Enforcement Regulations**) to include certain provisions from the Proposed Regulations. A corporation with annual revenue greater than $5 million that is found to have contravened a regulatory provision listed in the Enforcement Regulations would also be liable to a fine ranging from $100,000.00 to $6 million for a first offence and $200,000.00 to $12 million for a second or subsequent offence.[5] In the case of corporations with less than $5 million annual revenue, fines are between $25,000.00 and $4 million for a first offence, and $50,000.00 to $8 million for a second or subsequent offence.[6]

Constitutionality

Many in industry, as well as Alberta's Premiere, Danielle Smith are of the view that the Proposed Regulations are a *de facto* cap on production that has the effect of regulating in areas that are within the exclusive provincial domain, such as property and civil rights in the province (s. 92(13)), matters of a local nature (s. 92(16)), local works and undertakings (s. 92(10)), and non-renewable natural resources, forestry resources, and electrical energy (s. 92A). Premiere Smith has stated that the province intends to challenge the Proposed Regulations as unconstitutional.

Conclusion

According to the Government of Canada, the Proposed Regulations are designed to stimulate decarbonization investment and create a pathway for the oil and gas sector to achieve net-zero emissions, all without sacrificing production levels. Despite placing a cap on emissions, Environment and Climate Change Canada projects that the Proposed Regulations will have a minimal effect on Canadian oil and gas production levels. By its estimation, production will increase by 16 percent between 2019 and 2032 with the Proposed Regulations in place, versus 17 percent without the new rules.

While this is a legitimate objective, the Proposed Regulations add significant uncertainty and complexity to an industry already confronted with difficult investment decisions. Large-scale decarbonization projects are highly capital intensive and it takes several years to receive the necessary regulatory approvals. Many industry participants have expressed concern that this uncertainty and complexity will reduce investor confidence, putting decarbonization projects at risk of being delayed or abandoned altogether. Without adequate investor support, operators may be unable to develop decarbonization technologies at scale or in a timely manner and, consequently, may be forced to consider shutting production to comply with their remittance obligations.

Whether or not the Proposed Regulations are constitutional, the regulatory uncertainty created by the announcement of the emissions cap, coupled with the overt policy tension that exists between the federal and some provincial governments, will likely have a chilling effect on investor confidence and suppress the robust pace of decarbonization investment in Canada. The federal and provincial governments must establish clear and streamlined regulations regarding project development and climate change if Canada is to maintain sufficient production to respond to global demand and remain on track to meet its 2050 net-zero target.

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[4] *Regulations Designating Regulatory Provisions for Purposes of Enforcement (Canadian Environmental Protection Act, 1999),* SOR/2012-134.
[5] *Canadian Environmental Protection Act, 1999,* SC 1999 c 33, at section 272(3). [**CEPA**]
[6] CEPA, at section 272(4).