Why we need a robust and ambitious

cap on emissions from the oil and gas sector

BACKGROUNDER

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environmental defence

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Context

The Government of Canada has released the long awaited discussion paper on the oil and gas emissions cap, in line with their commitment to "cap oil and gas emissions today, and ensure they decrease tomorrow at a pace and scale needed to reach net-zero by 2050," with five year binding targets as milestones along the way.

The oil and gas sector is Canada's largest source of emissions: reducing these emissions is critical for Canada to make real progress on its climate commitments. However, until now, the oil and gas sector's continuous expansion has gone unchecked in Canada: there have been no limits to how much climate pollution the sector can create. Previous climate plans have all failed to meaningfully address the sector's growing emissions.

The Prime Minister's credibility on climate change depends both on if this policy is ambitious and robust, and on whether the government is able to implement this policy within the next year. We can't afford any more delays on this key policy, nor can we afford to have a weak approach if we are to reach global climate targets. Already we have seen the oil industry create doubt and perpetuate misinformation in the media, lobbying for delays and a weak cap.

The discussion paper, lacking in specific details, proposes two policy options to achieve oil and gas emissions reductions; a cap and trade model or a modified carbon pricing model. Both of the policy options proposed in the discussion paper are concessions to the oil and gas sector. However, the cap and trade model does provide more certainty and is the stronger option out of the two - if strong rules are put in place to ensure ambitious emissions reductions from within the oil and gas sector.

The consultation period for the discussion paper ends September 30th 2022. It is crucial that the government earnestly consider the responses from civil society and work to strengthen their approach.

Emissions from the Oil and Gas Sector

Despite accounting for just 5% of Canada's economy, the oil and gas sector is responsible for 26% of Canada's emissions, more than any other sector. While other sectors reduced emissions–most notably electricity, heavy industry, and light manufacturing–greenhouse gas emissions from the oil and gas sector have risen 87% since 1990.

Benefits of capping emissions from Canada's oil and gas sector

- It is evident that provincial policies regulating oil and gas sector emissions are not up to the task, because the sector's emissions have continued to rise. This federal policy, if

done correctly, could be a key tool that is necessary to tackle Canada's largest growing source of emissions.

- Capping oil and gas emissions is necessary for Canada to reach its domestic and international climate targets, and reduce the worst impacts of the climate crisis. According to the U.N., to limit warming to 1.5 degrees, global emissions have to drop 7.6% every year this decade. Canada will not reach its share of that target without addressing oil and gas emissions.

- Energy markets are shifting rapidly. The IEA predicts that on the pathway to achieving net-zero emissions by 2050, global oil demand will drop to 24 million barrels per day in 2050, down from 98 million barrels per day in 2019. As high-emission, high-cost oil, the Canadian oil sector is particularly vulnerable to drops in oil demand. An emissions cap is an opportunity to steer our economy towards a more competitive direction in a global context that is fast evolving.

- A well-designed cap with a prescribed trajectory to achieve zero emissions by 2050 would provide predictability to industry, workers, and communities. This in turn will drive innovation and private investments, and will lower the risk of stranded assets and dead end approaches.

- The oil and gas sector is experiencing record revenues because of rising oil and gas prices due to the crisis in Ukraine and cost-cutting measures achieved through automation, consolidation and workforce streamlining. Given these high revenues, the sector is well-placed to invest in additional emissions reductions now.

- Without a robust target for reducing oil and gas emissions, a greater burden for emission reductions would shift to other sectors of the economy and onto individuals.

Setting the right cap level to reduce emissions immediately on a 1.5 pathway

The government has not yet identified a 2030 emissions cap level in the discussion paper. However, the discussion paper does reference the federal government's Emissions Reduction Plan (ERP), released in March 2022, which projected that the oil and gas sector should reduce its emissions by 31% below 2005 levels by 2030.

This target is not aligned with ensuring the oil and gas industry does its fair share. This target does not line up with the Government of Canada's current domestic commitment - a decrease of emissions by 40-45% from 2005 levels by 2030. Furthermore, Canada's whole-of-economy "fair share" climate target is a 60 per cent emissions reduction by 2030 compared to 2005 levels. In the interest of fairness and accountability, the 2030 cap on oil and gas emissions should be in line with a 60 per cent reduction from 2005 levels, putting the emissions cap at 68 million tonnes in 2030. A strong 2025 cap is also needed to ensure reductions start immediately.

Although the 60% reduction in emissions is ambitious, it is both necessary for the climate and possible. **Oil and gas companies can meet the reduction target by:**

- Reducing methane emissions: According to Canada's GHG inventory, nearly 30 per cent of GHG emissions from oil and gas facilities are in the form of methane (and scientific research shows that's a significant underestimate). Reducing those 50 million tonnes is very cheap–88 per cent methane reductions are possible right now at less than $25/tonne. A dozen large oil companies have even pledged to reach "near zero" methane emissions by 2030. The Government of Canada has existing regulations in place to decrease methane emissions by 2025, and is currently developing 2030 regulation.
- Not developing any new oil or gas projects. According to the International Energy Agency, there can be no new fossil fuel projects on the pathway to 1.5 degrees. If this guidance is heeded, natural decline from existing projects would lead to a drop of just over 30% in Canadian oil and gas output from 2020 to 2030.
- Reducing emissions from the production of oil and gas, for example through electrification, switching to green hydrogen and operational efficiencies.
- If oil and gas companies aren't able to meet the target through the above measures, then companies will have to curtail production to stay within cap levels. Production cuts are likely necessary in order to ensure a safe future. In fact, a recent report has found that wealthy, economically diversified countries like Canada need to phase out their extraction of oil and gas by 2034 for the world to maintain a 50% chance of limiting warming to 1.5°C.

Proposed policy options from the federal government's discussion paper

The federal government has proposed two policy options to cap oil and gas emissions in line with their commitment of achieving net-zero by 2050: industry-specific cap and trade and a steeper carbon price that would apply only to the sector. Although both options fall short of what is needed to reach Canada's goals, the cap and trade model does provide more certainty and is the stronger option out of the two. Both of these options would be implemented in addition to existing federal and provincial regulations.

A new cap and trade system under Canadian Environmental Protection Act (CEPA)

- Sets out a ceiling for emissions for oil and gas sector, establishes a total quota of allowable emissions, which decline over time;
- Auctions emissions to companies, and the total amount of allowances would decline over time; and
- Provides the federal government certainty in terms of reaching the emissions targets.

Modify the current industrial carbon pricing system imposed on the oil and gas industry

- Adds a steeper carbon price on the sector to curtail emissions, that would come into effect as needed; and
- Cap level would not be enshrined in regulations, and therefore there is no way to enforce a specific target level or ensure certainty that targets will be met.

The Government of Canada could have proposed a hard cap on oil and gas industry emissions, without allowing companies to trade. Allowing for trade carries the risk of weak rules that could undermine the effectiveness of the cap. To safeguard against loopholes, strict trading rules must be developed to ensure that the oil and gas industry is finally held accountable for their emissions.

The government has committed to having final regulations in place before the end of 2023. Furthermore, the 2025 and 2030 targets should be announced before the end of the year in order to send immediate and clear signals to the industry. However, the oil and gas industry is already signaling that it will push to delay that timeline.

Principles of a "hard" or absolute cap on emissions

This is a real opportunity for the Government of Canada to get a handle on the most polluting sector in Canada. We can not afford a weak emissions cap that doesn't hold the oil and gas industry accountable. There are many ways to design an emissions cap and getting it right matters. If the federal government is sincere in ensuring Canada does its fair share on a global scale, and is serious about prioritizing our health and future over profits, it must include the following principles in the emissions cap.

- **Aligned with the Paris Agreement of keeping global warming below 1.5°C**. The emissions cap needs to reflect Canada's responsibility to do its fair share of emissions reduction to keep global temperatures below 1.5°C, which would be an emissions reduction of 60% from 2005 levels for the oil and gas sector, by 2030. A strong 2025 target is critical to favor early and ambitious emissions reductions. Front-loading climate action, paired with long-term planning over several years, is the most cost-effective way to reach a given temperature target. Failure to reduce emissions early could make later emissions targets impossible to achieve.

- **An enforceable, hard cap on absolute levels of emissions**.

- **No loopholes and relief valves that let companies off the hook**. Emissions reductions must happen within the sector, not through purchasing offsets for reductions elsewhere. Companies should only receive credit for proven reductions, not hypothetical reductions based on speculative technologies.

- **Has strong within-sector trading rules in place**. There must be robust rules in place to guard against the risks inherent in cap and trade approaches. Well-documented pitfalls have plagued different trading schemes, including the over-allocation of free

credits (sometimes referred as “hot air”), price ceilings (that prevent prices from reaching levels that drive down emissions) and delayed timelines.

Key trading considerations:

- Limit trade to within the oil and gas sector.
- No free allocation of credits.
- No price ceilings.
- Exclude offsets, including Internationally Transferred Mitigation Outcomes (ITMOs)
- Exclude any early-reductions carryover**.** Emissions reductions achieved before the cap is implemented should not be accounted for and rewarded by the policy.

- **Includes strong enforcement measures.** Penalties or fines should be significant amounts that serve as a strong deterrent rather than allow companies to internalize these as a small cost of doing business. Compliance mechanisms that are not financial should also be considered, such as mandated production cuts or use of the criminal powers allowed under CEPA.

- **Establishes cap at 2019 levels.** Canada produces a greenhouse gas inventory with a two year delay. Therefore when the Prime Minister promised to cap at today’s levels in the fall of 2021, the available emissions data was for 2019: 191 million tonnes. That should be established as the baseline year above which emissions can’t rise. The need for additional GHG emissions data should not be used as an excuse for delay.

- **Does not subsidize oil and gas companies for regulatory compliance.** Canadian environmental policy is founded on the Polluter Pays principle. Oil and gas companies collectively made $86 billion in post-tax revenues in 2021, and are projected to make over $100 billion this year. It is reasonable to expect that these companies will clean up their own mess without having to rely on taxpayers to foot the bill, including for unproven technologies such as CCUS and blue hydrogen. The implementation of the cap should also not undermine the Government of Canada’s commitment to phase out fossil fuel subsidies.

- **Upholds Indigenous rights.** The policy must uphold the inherent title and rights of Indigenous peoples and other rights affirmed in the United Nations Declaration on the Rights of Indigenous Peoples (UNDRIP), including securing Indigenous Peoples’ free, prior, and informed consent for energy development on their territory.

- **Integrates equity into policy development.** Taking care of people and their communities should be the first priority of the federal government when considering unintended consequences of climate action. Potential impacts related to implementation of the cap should be assessed and fully integrated into broader just transition planning, so that affected workers and communities can be fully supported. Proceeds from the auctioning of emissions credits under the cap and trade model should be used to support affected communities and workers, and communities who have been negatively

impacted by the sector historically, specifically low-income, Indigenous and racialized communities.

- **Includes all emissions from the production of oil and gas**. The vast majority of fossil fuel emissions - 80-85 per cent - are produced when the oil and gas is burned, mostly overseas. In fact, in 2019 the emissions from the fossil fuels exported by Canada were 954 million tonnes, considerably greater than Canada's entire domestic emissions (730 million tonnes). Though the policy mechanism for these 'downstream' emissions won't be the same as the hard cap on direct emissions, other policy approaches should be considered, for example the federal government could impose limits on oil and gas exports.

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