environmental defence

Submission to Environment and Climate Change Canada

Oil and Gas Emissions Cap:

Discussion Paper Recommendations

September 29, 2022

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Emissions Cap Discussion Paper Response

Introduction

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. 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. An emissions cap is also an opportunity to steer our economy towards a more competitive direction in a global context that is fast evolving, and where demand for oil is set to rapidly fall.

Of the two options put forward in the ECCC discussion paper, the cap and trade approach provides more certainty and is the stronger option out of the two. 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 creating stranded assets and dead-end approaches.

There are many ways to craft an emissions cap and proper design matters. Because 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 current profits, it must address the following principles in the design of the emissions cap.

- **Align with Canada's obligations under the Paris Agreement to limit global temperature increase to 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 requires an emissions reduction of 60% from 2005 levels for the oil and gas sector by 2030. An interim strong 2026 target is also critical to favour 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 emissions reduction and failure to reduce emissions early could make later emission targets impossible to achieve.
- **An enforceable, hard cap on absolute levels of emissions (not intensity caps)**.
- **No loopholes 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 or risky and failure prone nature-based solutions.
- **Includes strong within-sector trading rules**. 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.

The Prime Minister's credibility on climate change depends on the level of ambition, robustness and timely deployment (2023) of this policy. Furthermore, the 2026 and 2030 targets should be announced before the end of the year in order to send immediate and clear signals to the oil and gas industry. 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.

General

1. How do you envision the future of the oil and gas sector in the Canadian economy or your community?

   Currently, countries around the world are working to transition their economies from fossil fuels to renewable forms of energy. With advances in technology, renewable sources of energy have become more cost effective in recent years than fossil fuels. . In addition, the on-going damages that communities across the planet are facing because of climate change has further increased global awareness of the dangers of ongoing fossil fuel use. 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 by 2050, down from 98 million barrels per day in 2019. As a source of high-emission, high-cost oil, the Canadian oil sector is particularly vulnerable to decreasing oil demand. Capping and decreasing oil and gas emissions is not only necessary for Canada to meet its climate commitments, it is also an opportunity to steer our economy towards a more competitive direction in a rapidly evolving global context. A strong emissions cap will provide predictability to industry, workers, and communities. This in turn will drive innovation and private investments, and will lower the risk of creating stranded assets and dead end approaches.

   Oil and gas production must fall 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.

2. What do you see as the role of your organization or community in contributing to reducing oil and gas sector emissions in Canada?

   Environmental Defence Canada (EDC) is a leading Canadian environmental advocacy organization that works with government, industry and individuals to defend clean water, a safe climate and healthy communities. EDC works to support policy and decision makers to ensure they have the best evidence available to guide decision making and we work to communicate and translate scientific and economic impacts of climate change and the energy transition. Our role is to help build the case for and alignment around the energy transition in Canada.

3. What are the benefits or drawbacks of the options outlined in the discussion document?

A cap on emissions from the oil and gas sector is a critical tool for tackling the climate crisis. The emissions cap is a responsible and practical way to drive down emissions from this sector, if it's well designed and is sufficiently ambitious.

- 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 have reduced emissions–most notably electricity, heavy industry, and light manufacturing–greenhouse gas emissions from the oil and gas sector have risen 87% since 1990. To make any serious progress towards Canada's international climate commitments, there is a significant need to get the sector's emissions under control.
- 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. 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.
- 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 creating stranded assets and dead end approaches.

We are encouraged that the focus of the emissions cap design is on reducing absolute emissions from the sector. Carbon intensity targets are an inadequate approach as they aim to only cut carbon pollution relative to productivity or output, and do not result in overall reductions in emissions since production can expand while carbon intensity decreases: no realistic 1.5-aligned decarbonization pathway allows for growth in production.

The government must also consider the speed at which the policy is implemented, the trajectory, and the rules that accompany the policy. The government should focus on ensuring that a policy is implemented before the end of 2023 to ensure that Canada has a fair shot of meeting its targets in 2030 and stay aligned with the 1.5 degrees pathway. Furthermore, the 2026 and 2030 targets should be announced before the end of the year in order to send immediate and clear signals to the industry.

Although EDC is recommending the cap-and-trade option as the stronger option out of the two proposed in the discussion paper, EDC's preferred option is a hard cap, without trade. Allowing for trade carries the risk of creating weak rules that could undermine the effectiveness of the cap. At the very least, the cap without trade approach should be considered as an interim approach that can be implemented in the short term, while a trading system is being developed.

This approach would include implementing a hard cap on individual facility emissions under CEPA, calculated based on the performance-based standards used for the OBPS. Section 93(1) of CEPA allows Cabinet to adopt regulations respecting the "quantity or concentration" of GHG emissions released into the environment, among other matters. Although the government has generally used this section to impose emissions intensity requirements – for example, for coal-fired and natural gas-fired electricity generation regulations, this provision can and has been used to impose absolute limits on emissions of substances including GHGs. For example, the federal government adopted regulations imposing absolute limits on HCFCs, to meet the Montreal Protocol commitment. Under this approach, emission allocation would be determined according to equations set out by regulation.

Like with cap and trade, this measure would be implemented under CEPA and it could adopt processes that would be the same for cap-and-trade with respect to monitoring, reporting, verification and enforcement. Regulatory complexity and administrative burden on facilities would be minimized by relying on aspects of the current OBPS (the performance standards) while implementing processes that will also be required for cap-and-trade.

This interim approach would ensure that oil and gas emissions are capped immediately, and provide learning for the government as it develops the cap-and-trade approach.

4. Of the two approaches outlined, is there an approach your organization or community would prefer?

Out of the two policy options proposed in the discussion paper, the cap-and-trade option is the stronger out of the two, because it provides certainty in terms of reaching specific absolute emissions targets, as opposed to the carbon pricing option. The carbon pricing model does not allow the government to enforce an emissions reduction target, and therefore could allow the industry to miss the targets without a meaningful and compliance inducing penalty.

5. Do you have suggestions on how to improve the options outlined?

There are many ways to craft an emissions cap and proper design matters. Because 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 design of the emissions cap in order to limit loopholes and relief valves which would undermine the effectiveness of the policy:

- **Emissions reductions must occur within the sector.** Companies should not be allowed to purchase offsets for reductions elsewhere. Companies should only receive credit for proven reductions, not hypothetical reductions based on carbon

capture projects that have yet to be commissioned and have not demonstrated actual emissions reductions.

- **Strong rules for within-sector trading** . 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, 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 enough to 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.

- **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) and legislated by the Government of Canada, 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. Some jurisdictions have implemented equity considerations into the design of their emissions cap approaches. For example, California's cap and trade requires 35% of cap-and-trade revenue to be reinvested in disadvantaged communities.

Once a cap is in place for oil and gas, this approach can be replicated in other sectors of the economy as required. However, those sectoral caps can be created after the oil and gas sector emissions cap policy is finalized. The creation of caps for other sectors should not be an excuse for delay.

6. What potential short or long-term socio-economic impacts do you foresee or anticipate for particular regions or population groups resulting from an oil and gas emissions cap in general, and more specifically, the two proposed regulatory options?

   The Government of Canada is responsible for taking care of the people and communities that have been or will be impacted by the impacts of climate change as well as those impacted by the transition to a zero emissions future. Driving down emissions from the oil and gas sector may require some facilities to come offline. 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. Some jurisdictions have implemented equity considerations into the design of their emissions cap approaches. For example, California's cap and trade requires 35% of cap-and-trade revenue to be reinvested in disadvantaged communities.

Scope of coverage

7. Should consideration be given to facility emission thresholds to set different approaches and requirements for small versus large emitters?

   No

8. Should the cap include petroleum refineries and natural gas transmission pipelines?

   Yes. The cap should be comprehensive in scope. All oil and gas activities and facilities in Canada, including pipelines, refineries and liquefied natural gas (LNG) export facilities, should be covered by the cap.

9. Are there other considerations relevant to determining the scope of the cap?

   The emissions cap should cover all greenhouse gas emissions, and all the facilities in the oil and gas sector. All emissions - including carbon dioxide, methane, and all other greenhouse gasses included in Canada's National Inventory - associated with the extraction, production and refinement of oil and gas must be covered by this policy. This

includes emissions from primary production, enhanced oil recovery, co-generation activities, and new upgrading. Inactive and orphaned infrastructure should also be included in the emissions cap.

Alongside the development of the emissions cap, the government should consider other policy approaches to address the emissions from exported fossil fuels, for example, the federal government could impose limits on oil and gas exports. 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). Although this wouldn't fit within the proposed emissions cap, this is still a considerable impact that the oil and gas industry has on our planet that needs to be addressed to ensure we are aligned on the pathway to 1.5 degrees.

Emissions cap trajectory

10. What are the relevant considerations for determining a GHG emissions trajectory, particularly over the first 10 to 15 years?

The emissions cap needs to reflect Canada's responsibility to do its fair share to keep global temperatures below 1.5°C and align with the objectives of the Paris Agreement. The emissions cap must reflect the rapidly shrinking global carbon budget and Canada's responsibility and capacity, as a wealthy and high-emitting country, to do its fair share of the global effort, without shifting undue burden to other countries.

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 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. 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

At a minimum, the emissions trajectory must align with the Government of Canada's current commitments. However, analysis by Climate Action Network Canada shows that in order for Canada to do its fair share of the global effort to limit warming to 1.5°C, emissions must be reduced by at least 60% below 2005 levels by 2030. 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 64 million tonnes in 2030. A strong 2026 cap is also needed to ensure reductions start immediately.

Although a 60% emissions reduction target 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 40-45% by 2025, and is currently developing the 2030 regulation.

- Not developing any new oil or gas projects. According to the International Energy Agency, there can be no new fossil fuel projects if warming is to be kept below 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.

11. How should the trajectory of the oil and gas emissions cap be designed to support Canada's 2030 targets and achieve net-zero by 2050? Should the cap set annual or multi-year emission levels?

The emissions cap must favor immediate emissions reduction and prevent delays to achieve Canada’s climate commitments. Front-loading climate action, paired with long-term planning over several years, is the most cost-effective way to reach a given temperature target. If Canada fails to reduce emissions early, it may prove to be impossible - or much more expensive - to achieve targets later on. If emissions do not drop quickly and steeply, the chance to limit global warming to 1.5 degrees could be lost — even if global emissions reach net-zero by mid-century. The best way to ensure this is by enshrining ambitious 2026 and 2030 targets into the regulation.

The regulation should include a requirement to set 5 year decreasing targets along a pathway that ensures Canada is no longer producing emissions by or before 2050. The trajectory should draw a line between 5 year caps so that there’s yearly incremental decreases, creating a contiguous 5-year compliance period to 2050.

12. Should the trajectory be fixed out to 2050, or should the approach include steps to ratchet up the trajectory at one or more fixed intervals?

If the trajectory is not fixed out to 2050, then the only adjustments allowed in this policy should be to strengthen the policy with stronger targets at every 5 year intervals.

Competitiveness and carbon leakage

13. What design features should be considered to maintain Canadian competitiveness and minimize the risk of carbon leakage?

Cap and trade schemes typically grant free allowances to covered firms to prevent leakage and safeguard competitiveness. But this feature has drawbacks. It fails to give full incentives to firms to decarbonize and it fails to transmit the carbon price down the value chain to consumers. As such, a cap-and-trade scheme for oil and gas should not offer free allocations, but rather should auction all emission allowances and include a price floor. For Canadian oil and gas sectors, leakage in the domestic market is not a threat as there is no real possibility that non-carbon-priced imports to Canada will displace domestic production of oil and gas. Leakage in our export markets is not likely to be significant either, as many of Canada's export buyers have few available alternative supplies of heavy crude. Increased costs for Canadian producers would more likely simply mean less profit, but not lost markets.

The threat of leakage should not be used to justify a weaker emissions cap on the oil and gas sector. Canada needs to have a robust cap to reduce GHG emissions and meet our climate commitments. A stringent cap would also provide certainty to communities and workers, and support in the energy transition off of fossil fuels.

14. What compliance flexibilities should be allowed, and what conditions should determine eligibility?

There should be no compliance flexibilities allowed as these undermine the effectiveness of the cap and introduce exploitable loopholes. The oil and gas industry has had decades to address their emissions but instead, while other sectors have successfully reduced their emissions, their emissions have rapidly increased. Oil and gas companies have also benefited from decades of subsidies and regulatory support, without accountability for the air, land and water pollution they have caused. Furthermore, the industry continues to be a major obstacle to climate action, having lobbied to weaken, kill or delay every climate policy proposed by governments in Canada. Instead of providing compliance flexibility, the emissions cap must favor immediate emissions reduction in the early years, when the need to drive down emissions is most urgent.

15. Should the use of compliance flexibilities decline over time? If so, to what extent?

There should be no use of compliance flexibilities.

16. Under a potential cap-and-trade option, should distribution of allowances be done through auction, free allocation, or a combination of the two?

Allowances should only be distributed through auction. Over allocation of free credits is a well-documented pitfall of trading schemes, and allocating free credits waters down the effectiveness of the cap. A Canadian cap-and-trade scheme for oil and gas should not offer free allocation, but rather should auction off all emission allowances, with a price floor.
The proceeds from the auction should be used to support a just transition for communities and individuals that may be impacted by the emissions cap as well as communities affected by the impacts of fossil fuel production, and communities impacted by the transition off of fossil fuels. This redistribution would allow the benefits of this policy to be spread out and would increase buy-in.

Policy coherence and coordination across jurisdictions

17. Would there be merit in excluding or taking an approach that results in lower compliance costs for emissions generated from the production and processing of fuels used to support the development of clean fuels (e.g. natural gas required for low carbon hydrogen production)?

No, there is no merit to this approach. There is more and more research that proves that using hydrogen is not a climate-safe option. A recent study from Cornell and Stanford found that blue fossil hydrogen is even worse for the climate than burning coal or fossil gas directly, and concludes there is no role for fossil hydrogen in a carbon–free future. Furthermore, a recent study found that hydrogen itself acts as an indirect greenhouse gas.

18. How should the Government of Canada ensure that the cap incents investments in diversification and other preparations for a clean energy transition?

There should be no subsidies or public financing for the oil and gas industry to transition to clean energy. 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. Given these high net incomes , the sector is well-placed to invest in additional emissions reductions now. 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. Channeling proceeds from the auction of allowances to oil and gas companies would violate Canada's commitment to phase out fossil fuel subsidies.

Proceeds from the auctioning of emissions credits under the cap and trade model should be used to support communities and workers impacted by the cap to support a just transition off of oil and gas, and communities who have been negatively impacted by the sector historically, specifically low-income, Indigenous and racialized communities. Some jurisdictions have implemented equity considerations into the design of their emissions cap approaches. For example, California's cap and trade requires 35% of cap-and-trade revenue to be reinvested in disadvantaged communities.

19. How would each potential cap approach interact with other climate measures?

The emissions cap should work alongside climate measures such as OBPS, CFS, CER and Methane regulations, not replace them. The goal of the cap, along with the other climate measures, is to ensure Canada is on track to meeting its Paris Agreement targets. Therefore, as the emissions cap policy is developed, the other measures should also be continuously reviewed and strengthened to ensure maximum efficiency.

20. What opportunities exist for coordination among federal and provincial and territorial measures?

Implementation

21. How should a cap on GHG emissions be implemented to maximize emission reductions while avoiding potential challenges related to layering of multiple policies and regulations?

Self-interested oil industry claims of undue regulatory burden should not be used to justify a weak emissions cap. An emissions cap is a responsible and practical approach to constraining emissions from the oil and gas sector given that it is Canada's largest and growing source of emissions. An emissions cap does not need to result in undue red tape for industry, and at this juncture our sights must be laser focused on achieving the deep and sustained emissions reductions that align with a climate-safe pathway, not making it easier for industry to pollute.

In addition, the oil and gas industry's compliance with other policies (mentioned in question 18) would make it easier to abide by the emissions cap.

22. What other factors related to implementation should be considered in developing an approach to cap and cut GHG emissions from the oil and gas sector?

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. There should be meaningful engagement of rights-holders throughout the design of the policy to ensure its implementation takes into account Indigenous knowledge and expertise, for instance on the impacts of the proposed regulations

The federal government must also develop and implement a strategy to ensure a fair, managed, and supported transition for workers and communities dependent on the oil and gas industry. Research shows that phasing out oil and gas while taking care of those affected is entirely manageable for Canada, and successful transitions away from fossil fuels have been undertaken in other jurisdictions. The emissions cap policy will have impacts on workers and communities that need to be fully integrated into broader just transition strategies.