January 24, 2024

The Honourable Steven Guilbeault
Minister of Environment and Climate Change
200 boulevard Sacré-Cœur, 12e étage
Gatineau QC K1A 0H3

(via email: ministre-minister@ec.gc.ca and planpetrolieretgazier-oilandgasplan@ec.gc.ca)

RE: *A Regulatory Framework to Cap Oil and Gas Sector Greenhouse Gas Emissions*

Dear Minister Guilbeault,

I am writing on behalf of the Explorers and Producers Association of Canada (EPAC) which represents more than 100 upstream oil and natural gas producers that collectively produce more than 65 per cent of Canada's natural gas and more than 40 per cent of the country's oil. They employ tens of thousands of Canadians, attract billions of dollars in capital investment, and contribute billions of dollars in taxes and royalties to federal and provincial governments on an annual basis.

EPAC and its members remain committed to reducing greenhouse gas (GHG) emissions from the upstream oil and natural gas sector. In fact, emissions from the conventional oil and natural gas sector have been falling for several years now according to Environment and Climate Change Canada's (ECCC's) National Inventory Report (NIR).

However, **EPAC opposes the proposed sectoral emissions cap because it will serve as a cap on production that results in shut-ins (contrary to public statements), represents a significant regulatory burden on top of several other regulations that are reducing emissions from the sector, is economically inefficient and unfair, is harmful to investment in the sector (including for efforts to decarbonize production), and is likely unconstitutional.**

While EPAC is committed to actively participating in this round of engagement on the proposed policy, it is disappointed that its concerns have not been heard to date or reflected in the proposed framework.

Although it opposes the proposed emissions cap, EPAC and its members support the principle of carbon pricing and recognize the need for further action on methane. EPAC and its members further believe that it is possible to achieve deep decarbonization within the sector while continuing to provide the energy Canadians rely on and growing international exports to support our international allies and reduce global GHG emissions.

Proof that this is possible lies in actions occurring today. EPAC members, who already own or operate at least a portion of each of Canada's large-scale carbon capture, utilization and storage (CCUS) projects, are advancing additional CCUS projects. The conventional sector continues to electrify facilities where feasible and EPAC members are also actively investing in hydrogen projects, renewable energy, and new emissions reductions technologies. EPAC and its members will ensure that further emissions reductions from the conventional sector will be achieved.

Canada has long been a world leader in minimizing methane emissions from the oil and natural gas sector. This is due to the longstanding policies of the provinces that limit flaring, as well as more recent regulatory developments at the federal and provincial level. EPAC has also been mostly supportive of the Government of Canada and Government of Alberta's ambitious but realistic intent to reduce methane emissions from the sector by 75 per cent. Although EPAC believes the provinces should be the only regulators in this area, we are working constructively with your department to ensure draft methane regulations can achieve these reductions without impacting production. EPAC also continues to work with the provinces of British Columbia, Alberta, and Saskatchewan to build on the success of their existing and proposed regulations in the hopes that equivalency can be achieved.

Current Policy Environment

As has been pointed out by several prominent energy-focused Canadian economists such as Trevor Tombe and Andrew Leach, **the proposed policy is economically inefficient, undercuts the principles and objectives of carbon pricing, and treats emissions from one sector differently than others.**

The proposed policy instrument pancakes on to several other policies designed to reduce emissions from within the sector: carbon pricing as administered through the numerous federal and provincial output-based pricing systems (OBPSs) across the country, the fuel charge applied to any uncovered CO2 sources, and methane regulations, as well as applying to the oil and natural gas industry's Scope 2 emissions (primarily from electricity) which are covered by even further aggressive policies.

This pancaking of cost-based policies adds increasing complexity, a realized price of carbon that is different for each economic sector and that is significantly higher than needed for decarbonization to occur putting at risk the ability of Canadian industries to attract capital, employ Canadians and maintain the Canadian economy. In fact, **the very prospect of the proposed policy is having negative impacts on the ability of Canadian producers to attract foreign investment into Canada, including the crucial investment needed to reduce emissions, which harms the value of the Canadian dollar and the purchasing power of the Canadian economy.**

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The situation is exacerbated by the inability of the Government of Canada to advance positive incentives that would encourage capital spending on large decarbonization projects. The CCUS investment tax credit (ITC), which was first announced nearly three years ago, has still not been legislated let alone implemented. Draft legislation on the Clean Electricity ITC, announced in Budget 2023, will not be public until this summer. And, while the availability of carbon contracts for difference (CCfDs) through the Canada Growth Fund will help a few projects, the recent Fall Economic Statement indicated that the Government of Canada is backing away from a broad-based program of CCfDs, which harms the ability of companies to attract needed capital for CCUS and other decarbonization projects.

Rather than layering on additional costs for industry and limiting production, **the Government of Canada should be focused on attracting capital to the Canadian economy that would support multi-million dollar, multi-decade decarbonization projects and working with the provinces to remove barriers to decarbonization.**

Impacts to Production

By selecting a cap-and-trade policy, ECCC has chosen a policy mechanism that, by its very nature, sets an upper bound on production and therefore serves as a production cap, limiting the ability of the provinces to regulate and develop their resources beyond the production scenario that has been used to develop the level of permissible emissions under the cap in 2030.

The framework indicates that the emissions cap is set based on 2019 production levels and a requirement that all that production is fully abated at levels based on assumptions ECCC has made as to what is technically achievable by the sector in 2030. If ECCC is correct in its assumptions, industry cannot reduce emissions further than modeled and the policy explicitly limits production to 2019 levels. In fact, this represents a required production cut given that production has increased since 2019. According to Statistics Canada, Canadian natural gas production for January 2019 was 16 bcf/d and rose to 18 bcf/d in August 2023, while oil production averaged 4.1 Mbbl/d in January 2019 and rose to 4.4 Mbbl/d in September 2023. If ECCC is wrong in its technological assumptions, the production cap could be even lower than 2019 levels and shut-ins resulting from the policy will be even more severe.

While the framework contemplates some compliance flexibility for the sector, possibly up to 25 MtCo2e/yr, those compliance flexibilities would still cap production at levels assumed under the Canadian Energy Regulator's (CER's) Canadian Net-Zero (CNZ) Scenario. Here it should be noted that natural gas production in August 2023 already exceeded the peak of 17.7 bcf/d projected by the CNZ Scenario.

There is also no guarantee the proposed compliance flexibilities will be operational by 2030. As the CER admits in its Canadian Energy Future 2023, there are also several significant

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uncertainties built into the assumptions leading to the CNZ scenario which questions the accuracy and reliability of the scenario.

At this point, the proposed decarbonization fund represents nothing more than an additional carbon charge on top of existing charges under federal and provincial OBPSs. Robust and widely available domestic offsets are not currently available at the scale needed to achieve reductions of 25 MtCO2e/yr by 2030. ECCC has been slow to develop the required protocols, it is unclear what offsets might be acceptable under the proposed cap, and the offsets will presumably only be available for a single compliance obligation (i.e. under the emissions cap or an OBPS), limiting their value under the proposed policy. ITMOs under the Paris Agreement, while promising, are unlikely to be in place by 2030 given the reluctance of both Canada and its international partners to advance conversations around Article 6 of the accord.

The net result is the proposed policy still represents a production cap that results in shut-ins even if the contemplated compliance flexibilities are in place by 2030 as those flexibilities will only be allowed up to the "legal upper bound" of the policy. If the expectation of the policy is that companies deploy all feasible abatement technologies to meet the emissions cap, they cannot grow production and the policy is in fact a production cap. This will have significant economic impacts on the Canadian economy – to GDP, productivity, balance of trade, purchasing power, and ultimately exacerbate Canadians' ongoing concerns of affordability.

Finally, as EPAC has previously communicated, any production limit will not be felt uniformly across the sector. The conventional oil and natural gas sector (which produces lower emissions intensity products, is already reducing emissions, attracts more capital and employs significantly more Canadians across a much greater geography than other subsectors) will be disadvantaged by the proposed policy and see a disproportionate share of shut-ins. Under a production cap, lower emitting conventional oil and natural gas wells will be shut in long before other forms of production. **The policy will therefore lead to a higher emissions intensity oil and natural gas sector** with a substantial cost to conventional oil and gas companies and workers as well as the Canadian economy more broadly.

Concerns with Instrument Choice

In addition to its concerns with a production cap, EPAC is concerned by several specific impacts of the proposed framework. Because of the complexities and interactions expressed below, **EPAC is doubtful that ECCC can draft a policy consistent with the proposed framework that meets the requirements of the Treasury Board's Policy on Regulatory Development**. Namely, the framework would seem to fail to meet the principles of evidence-based decision-making and support for a fair and competitive economy, since the evidence suggests the policy is a cap on production contrary to stated policy objectives, and the policy is clearly unfair to one economic sector and reduces the competitiveness of the Canadian economy.

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It is likely also not possible to meet the regulatory analysis requirements of Section 7 of the Treasury Board Policy. In EPAC's view, the proposed response is not proportional, will unduly impact other areas of regulation and flies in the face of regulatory cooperation with the provinces. Given the inability to effectively model the proposed policy's interactions with provincial OBPSs and other climate policies, it is also highly unlikely that ECCC can produce a good-faith regulatory impact analysis statement. In fact, given the policy is meant to continue to be in place and evolve until at least 2050 but provides no details on the period from 2030-50, it is impossible to model the consequences of the full scope of the policy.

Given the cap on production and concerns expressed by Indigenous organizations such as the Indian Resource Council and the Indigenous Resource Network, the proposed policy would also seem to **impact Article 2 of UNDRIP and the right of Indigenous peoples to freely pursue their economic development and should therefore require full consultation across all impacted Indigenous nations and interests.**

Inclusion of Methane

EPAC has been generally aligned with ECCC on the need to further reduce methane from the upstream oil and natural gas industry and has agreed on the need to work towards the Government of Canada's goal of reducing those emissions by at least 75 per cent. While EPAC has expressed some concern with the draft methane regulations, it continues to be committed to working constructively with ECCC to achieve the government's desired outcome.

The inclusion of methane emissions in the proposed cap, however, adds significant administrative and compliance costs to the already meaningful regulatory burden contained in the draft regulations, which ECCC estimates to be in the range of $15 billion. **The inclusion of methane emissions in the cap will see no additional emissions reductions. It is simply adding costs onto the sector for the sake of adding on costs.**

Furthermore, methane emission within the sector are not equally distributed across commodities, companies or facilities. Therefore, the cap-and-trade system will see some companies subsidize others for emissions reductions that they are required to undertake through the methane regulations, further punishing some companies for complying with the regulations. Not only is this interaction economically inefficient, but it also distorts the very purpose of the cap-and-trade system and the methane regulations.

Interaction with federal and provincial Output-based Pricing Systems (OBPSs)

The proposed policy will have costly, but unknown implications for exiting OBPSs which are meant to price and drive down emissions from all trade-exposed industrial sectors. The policy will duplicate reporting and increase the compliance cost of every ton of emissions subject to both policies. It will also presumably compromise the ability of credit generation and purchases

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available under provincially regulated OBPSs with unintended outcomes for Canadian industry beyond oil and gas. Apart from the direct cost implications to the oil and natural gas industry, the policy has a potential to impact the overall effectiveness and viability of OBPSs in British Columbia (currently under development), Alberta and Saskatchewan as the oil and natural gas industry represents the largest source of covered emissions in each of those provinces.

In addition, many elements of the proposed policy are identical to those of the provincially administered OBPSs – they each have government-determined free allocations, a price on carbon, the ability to generate and sell performance credits and use offsets, and both drive down emissions. The proposed policy however would seem to be designed to override the operations of the provincial OBPSs in ways ECCC cannot anticipate, unfairly isolate one sector from the rest of the industrial economy, and limit the production capacity of the same industry.

Given the complexities of the interactions, EPAC fails to see how ECCC could adequately model the implications of imposing a cap-and-trade system on top of existing OBPSs administered by the federal government and the provinces.

Inclusion of Scope 2 Emissions

Electrification of the conventional upstream oil and natural gas industry remains a key decarbonization pathway. However, **the inclusion of Scope 2 emissions as proposed in the policy would discourage the use of electricity to decarbonize the sector** by adding additional costs and making the oil and natural gas sector responsible for the emissions of electricity providers, which are beyond the control of the purchaser of electricity. The electricity sector already faces significant regulations by provinces, is subject to carbon pricing through OBPS, and is proposed to be regulated by the draft Clean Electricity Regulations. Adding an additional layer of regulation to emissions from electricity for one sector is unnecessary, costly, counter-productive, and unfair. The additional costs encourage production shut-ins rather than decarbonization, contrary to the stated goals of the policy.

In addition, CCUS projects, another significant decarbonization pathway for the sector, will require a significant amount of electricity in a highly decarbonized world. The additional cost and burden of including emissions from electricity providers will reduce extremely narrow profit margins of CCUS projects and remove the potential for decarbonization within the sector, contrary to the stated goals of the policy. **Adopting a further barrier to CCUS development in this manner will encourage production shut-ins rather than decarbonization of the sector.**

Inclusion of LNG

As stated in its September 2022 submission, EPAC does not believe LNG facilities should be included in any proposed emissions cap. The shipment of LNG from Canadian shores presents a unique opportunity for Canada to contribute to the energy security needs of our allies, reduce

global GHG emissions, and provide significant economic growth domestically. Including LNG facilities, which will have limited abatement options once built, will further reduce allowable domestic production under the cap and the compliance costs associated with LNG facilities will either reduce the competitiveness of Canadian LNG or ensure costs are passed back to producers who will be held responsible for emissions that are beyond their control.

It should be noted that the CER CNZ Scenario which is used as the basis of the proposed policy does not account for all approved LNG facilities. In addition, the CER CNZ Scenario does not assume that natural gas production increases to correspond with new volumes associated with LNG facilities when they come online. This implies that nearly all production to support LNG development is assumed to be absorbed from current production rather than representing increased production. Therefore, the legal upper bounds set by the policy would see decreased domestic production for domestic uses, limiting supply and increasing costs to Canadian consumers who are already struggling with affordability issues.

There is also an inherent policy inconstancy requiring the inclusion of LNG within the cap when other infrastructure used in the transport and movement of oil and natural gas are excluded.

Constitutional Concerns

Considering recent court decisions limiting the powers of the Government of Canada to regulate GHG emissions and other environmental impacts, **EPAC is of the view that any regulations to operationalize the proposed framework would be unlikely to survive a court challenge.**

Furthermore, the provinces of Alberta and Saskatchewan have indicated they will explore all available legal options to prevent the operation of any laws or regulations from the federal government that impose an emissions cap on the oil and natural gas sector. This makes a court process challenging any regulations under the Canadian Environmental Protection Act (CEPA) inevitable.

Proceeding with the adoption and implementation of regulations will therefore lead to significant legal, policy and political uncertainties for industry in addition to the high compliance and administrative costs, limits on production and negative impacts to investment. These impacts will be for naught should the courts find the regulations to be, in whole or in part, unconstitutional.

Moving ahead with the policy without considering these provincial concerns also runs contrary to the Government of Canada's public commitment to work cooperatively with the provinces on climate related issues – which the Supreme Court of Canada (SCC) has advised is necessary.

Specifically, the framework raises the following legal complications:

Impacts to provincial jurisdiction

As outlined above, the proposed policy does represent a cap on production at some to-be-determined level. **The policy clearly impacts the ability of the provinces to manage and regulate the development of their oil and natural gas resources under Section 92A of the Constitution.**

Furthermore, in its judgments on *References re Greenhouse Gas Pollution Pricing Act, 2021*, and *Reference re Impact Assessment Act,* 2023, the SCC indicated that the Parliament of Canada does not have the ability to extend its jurisdiction to overstep that of the provinces for the sole purpose of regulating GHG emissions. Any such regulations must be in the proper bounds of the Constitution and tied to a federal head of power.

Ability to regulate GHG emissions of a given sector

In its judgment on the *References re Greenhouse Gas Pollution Pricing Act, 2021*, the SCC determined that the Parliament of Canada has the right to administer a uniform price on carbon across the Canadian economy under the Greenhouse Gas Pollution Pricing Act because the Government of Canada was able to show that the Act was properly tied to a federal head of power under the National Concern Doctrine.

However, the SCC made it clear that the decision was specific to the Act and not a broader determination on the ability of the Government of Canada to regulate GHG emissions. The decision explicitly states that the authorities under the Act are very different than a sector-by-sector regulatory approach to GHG emissions and suggests the SCC may look quite differently at sector-specific approaches in areas of provincial jurisdiction, which the proposed policy clearly represents.

Should the Government of Canada wish to argue the proposed policy is justified under the National Concern Doctrine, it would have to prove the provinces are unable to regulate in the narrow area of GHG emissions from the oil and natural gas sector and that the policy is not duplicative of provincial role.

On the first matter, the provinces clearly can regulate, and in fact are regulating, GHG emissions from the oil and natural gas sector through their OBPSs, as described above, and through provincial methane regulations. In fact, the federal government has accepted both sets of policies as being effective in the management of GHG emissions within the sector through formal recognition of these policies, and the NIR which shows emissions from the conventional oil and natural gas sector are falling.

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The only difference at hand are the proposed federal provisions that would limit production of oil and natural gas, which clearly fail the second test above given that Section 92A of the Constitution give the provinces the exclusive jurisdiction over the development, conservation, and management of non-renewable natural resources.

Ability to regulate GHG emissions under CEPA

Jurisprudence also raises significant questions as to whether the federal government can regulate GHG emissions under the federal criminal power administered through CEPA. Using established tests as set out by the SCC, the Government of Canada would need to prove that the policy prohibits an activity through the imposition of a penalty for a valid criminal law purpose.

The proposed policy, however, does not prohibit any individuals from emitting GHG emissions. It applies to a small subset of GHG emitting entities, oil and natural gas producers, and does not prohibit or perhaps even limit emissions from individual companies. In substance, the policy is a regulatory scheme that prices emissions and limits the production of natural resources which are quite clearly in the jurisdiction of the provinces under Section 92A of the Constitution.

Furthermore, the jurisprudence would question whether carbon dioxide and methane emissions can be captured by CEPA in the first place. The SCC in *R. v Hydro-Québec* determined the only substances that can be prohibited under CEPA are those that are toxic in the common meaning of the word. While EPAC agrees that GHG emissions must be reduced from the sector, there is reasonable doubt as to whether the courts would classify carbon dioxide and methane emissions as toxic given, they are not in their nature toxic to humans or animals.

Recommendations

Because of the concerns and uncertainties articulated above, **EPAC recommends the Government of Canada not proceed with the proposed sectoral emissions cap**.

Should the Government of Canada wish to proceed with further developing the policy despite these concerns, **EPAC strongly recommends the Governor in Council exercise its discretion under Sections 53(1) and 53(2) of the Supreme Court Act to refer any proposed draft regulations under CEPA to the Supreme Court of Canada** for a determination of the important constitutional questions that will be raised by the provinces and other intervenors before the Court. Exercising this discretion would avoid the significant costs and uncertainties to industry, investors and governments associated withstanding up CEPA regulations that may not survive or be significantly affected by a challenge that will come before Court.

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EPAC also recommends the Government of Canada fully consult on the proposed policy with impacted Indigenous Nations and business interests, consistent with its commitment to UNDRIP.

Finally, EPAC recommends the Government of Canada move quickly to implement its previously announced decarbonization incentives and work with industries across Canada towards a more coherent, balanced approach to climate policy that allows the Canadian economy to compete for the required capital and jobs to achieve large scale emissions reductions. A continued failure to balance market-based mechanisms and command and control regulations with incentives will see a further erosion of Canada's competitiveness harming the country's GDP and productivity.

EPAC would welcome the opportunity to further discuss its concerns regarding the proposed policy with you and others across the Government of Canada. Furthermore, EPAC welcomes the opportunity to continue to work constructively with you, your office, and your department on the implementation of climate policies that will decarbonize the sector in a way that does not negatively impact the production profile of the industry and the Canadian investment climate.

Should you wish to discuss these matters further, you may reach EPAC's Vice President Policy, Chris Montgomery, who is our lead on these files

Sincerely,

Tristan Goodman
President and CEO
The Explorers and Producers Association of Canada

CC:

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