WEST COAST Environmental Law

700-509 Richards Street, Vancouver, BC V6B 2Z6 | Coast Salish Territories
xʷməθkʷəy̓əm (Musqueam), Sḵwx̱wú7mesh (Squamish) & səl̓ilwətaʔɬ (Tsleil-Waututh)
T 604.684.7378 | 1.800.330.WCEL | F 604.684.1312 | admin@wcel.org
@WCELaw | wcel.org

West Coast Environmental Law Submissions on Regulatory Framework for an Oil and Gas Sector Greenhouse Gas Emissions Cap

Via email: **PlanPetrolieretGazier-OilandGasPlan@ec.gc.ca**

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Thank you for this opportunity to comment on the proposed oil and gas emissions cap framework. We are pleased that the federal government is making progress on this critical regulation for driving the oil and gas sector's emissions down in line with Canada's climate targets. We support the decision to proceed with a cap-and-trade system. As we wrote in our **2022 response** to the initial discussion paper on an oil and gas emissions cap, we believe that cap and trade has the greatest potential for ensuring that the oil and gas sector's emissions do not derail Canada's efforts to do its part on the international stage.

However, we are concerned that as proposed, the regulations will not achieve that objective, for three reasons:

1. The cap level is too low.
2. The scope is too narrow.
3. The so-called "compliance flexibilities" will undermine the effectiveness of the framework.

In our opinion, Parliament has jurisdiction to enact an oil and gas emissions cap that is at least 40%-45% below 2005 levels by 2030, in line with Canada's overall target, so long as the regulations are aimed at reducing the country's greenhouse gas (GHG) emissions (and thus are in pith and substance related to GHG pollution). In these submissions, we discuss Canada's jurisdiction to establish oil and gas emissions cap-and-trade regulations and recommend key elements that will help put the oil and gas sector – and Canada – on track to meeting its targets.

Summary Recommendations

Recommendation 1: Set the cap at 40-45% below 2005 levels by 2030.

Recommendation 2: Ensure the cap's predominant purpose and effects are to reduce GHG pollution from the oil and gas sector in line with Canada's economy-wide targets.

Recommendation 3: Do not allow compliance flexibilities such as ITMOs, offsets or the proposed decarbonization fund.

Recommendation 4: In addition to the facilities and associated activities outlined in the Framework, the cap should apply to all oil and gas storage and distribution facilities and their upstream pipelines, including marine shipping.

Recommendation 5: There should be no grace periods for new facilities.

Recommendation 6: Establish an auction for emissions allowances. If emissions are freely allocated for an initial transition period, minimize that period and require all new facilities to purchase their allocations.

Recommendation 7: Require reviews of the regulation in accordance target-setting under the *Canadian Net-Zero Emissions Accountability Act* (CNZEAA).

Set an Ambitious Cap Level

Recommendation 1: Set the cap at 40-45% below 2005 levels by 2030.

Recommendation 2: Ensure the cap's predominant purpose and effects are to reduce GHG pollution from the oil and gas sector in line with Canada's economy-wide targets.

We believe that an oil and gas emissions cap-and-trade system can be validly made pursuant to the criminal law power, and that such a system can, and should, cap emissions at 40-45% below 2005 levels.

Federal jurisdiction

To be valid, federal legislation and regulations must be in "pith and substance" related to a federal head of power (in this case, the criminal law power). A law's pith and substance are its precise "matter,"[1] its "dominant or most important characteristic."[2] In determining a law's pith and substance, a court will look to both its purpose and its legal and practical effects to determine its "main thrust."[3]

Secondary, or incidental, effects or objectives do not impact a law's constitutionality if its pith and substance falls within the legislating jurisdiction's authority.[4] "Incidental" is defined as including "effects that may be of significant practical importance but are collateral and secondary to the mandate of the enacting legislature."[5] In other words, an emissions cap may have significant, practical effects on provincial powers so long as its predominant purpose and effects are related to the criminal law power.

As a majority of the Supreme Court in *Canadian Western Bank* held:

> The "pith and substance" doctrine is founded on the recognition that it is in practice impossible for a legislature to exercise its jurisdiction over a matter effectively without incidentally affecting matters within the jurisdiction of another level of government. For example, as Brun and Tremblay point out, it would be impossible for Parliament to make effective laws in relation to copyright without affecting property and civil rights, or for provincial legislatures to make effective laws in relation to civil law matters without incidentally affecting the status of foreign nationals.[6]

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[1] ***Canadian Western Bank v Alberta*, 2007 SCC 22, [2007] 2 SCR 3** at para 26 [*Canadian Western Bank*].
[2] *Whitbread v Walley,* [1990] SCJ No 138, [1990] 3 SCR 1273 at para 15.
[3] *Canadian Western Bank, supra* note 1 at para 27; ***Kitkatla Band v British Columbia (Minister of Small Business, Tourism and Culture)*, [2002] 2 SCR 146, 2002 SCC 31** at para 54.
[4] *Canadian Western Bank*, *ibid* at paras 27-28.
[5] *Ibid* at para 28.
[6] *Ibid* at para 29.

In the *Firearms Reference*, the Supreme Court confirmed that the criminal law power is a "broad area of federal jurisdiction" that "often overlaps with provincial jurisdiction."[7] The Court explained:

> Put simply, the issue is whether the law is mainly in relation to criminal law. If it is, incidental effects in the provincial sphere are constitutionally irrelevant... On the other hand, if the effects of the law, considered with its purpose, go so far as to establish that it is mainly a law in relation to property and civil rights, then the law is ultra vires the federal government. In summary, the question is whether the "provincial" effects are incidental, in which case they are constitutionally irrelevant, or whether they are so substantial that they show that the law is mainly, or "in pith and substance", the regulation of property and civil rights.[8]

The Court rejected the argument that imposing gun licensing and registration requirements on gun owners and users was more than an incidental effect,[9] noting that the double aspect doctrine allowed the provinces to regulate the provincial aspects of firearms while the federal government regulates the safety aspects of them.[10]

Similarly, in *Reference re Genetic Non-Discrimination Act*, a majority of the Supreme Court upheld sections 1-7 of the *Genetic Non-Discrimination Act* as a valid use of the criminal law power despite the fact that the Act has significant practical effects on the insurance industry. The Act prohibits individuals and companies from requiring people to undergo genetic testing in order to obtain a good or service such as health or life insurance. The majority found that the heavy impact on insurers "does not overtake the prohibitions' direct legal and practical effects" of allowing people to protect themselves against genetic discrimination.[11]

Courts have also upheld criminal laws despite their incidental effects on the regulation of provincial health institutions[12] and property and civil rights in the province.[13] It has also upheld environmental laws enacted under other federal heads of power despite those laws having incidental effects on provincial matters. For example, in *Ward v. Canada,* the Supreme Court upheld a *Fisheries Act* prohibition against the sale, trade or barter of young hooded and harp seals as a valid exercise of the federal Parliament's authority under the fisheries power, dismissing arguments that the legal effect of the prohibition is to regulate property and therefore in relation to a provincial head of power.[14]

Such must be the case with setting a cap on emissions. The cap would be able to incidentally affect oil and gas production. Indeed, in upholding provisions of CEPA in *Hydro-Quebec,* the Supreme Court rejected the argument that the impugned provisions unlawfully affected provincial powers. Justice La Forest stated that he would be "concerned with an interpretation of the Constitution that effectively allocated to the provinces, under general powers such as property and civil rights, control over the environment in a manner that prevented Parliament from exercising the leadership role expected of it by

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[7] ***Reference re Firearms Act*, 2000 SCC 31, [2000] 1 SCR 783** at para 28.
[8] *Ibid* at para 49.
[9] *Ibid* at para 50.
[10] *Ibid* at para 52.
[11] ***Reference re Genetic Non-Discrimination Act*, 2020 SCC 17** at paras 59-60.
[12] ***Canada (Attorney General) v PHS Community Services Society*, 2011 SCC 44** at para 51.
[13] E.g., ***RJR-MacDonald Inc. v Canada (Attorney General)*, 1995 CanLII 64**.
[14] ***Ward v Canada (Attorney General)*, 2002 SCC 17 (CanLII), [2002] 1 SCR 569** at para 20.

the international community and its role in protecting the basic values of Canadians regarding the environment through the instrumentality of the criminal law power."[15]

Regulations constraining the production of toxins under the *Canadian Environmental Protection Act* (CEPA) inevitably affect production of both those products and of products which rely upon those toxins in their own production. This reality has never been interpreted to mean that CEPA regulations must be limited to levels that have only negligible impacts on production. At its core, CEPA aims to protect the public and the environment from the toxins it regulates – and not to regulate the manufacture of products which may release those toxins.

To be a valid use of the criminal law power, the pith and substance of the emissions cap must: (1) consist of a prohibition (2) accompanied by a penalty and (3) be backed by a criminal law purpose.[16] Protection of the environment is a valid criminal law purpose.[17] However, it must be clear that the regulation's purpose is to respond to the threat of harm that GHGs pose by capping emissions,[18] rather than some other purpose, such as allowing the oil and gas sector to be globally competitive and an efficient global supplier, or establishing a market for GHG emissions credits. To that end, it may strengthen Canada's jurisdictional case to set the cap at a level that is equivalent to 40-45% below 2005 levels, in line with Canada's target.

The Framework's rationale for the proposed cap level is flawed

The Framework proposes that the legal upper bound in 2030 be set at a level that assumes production levels in 2030 will be aligned with the Canada Energy Regulator's (CER) Canada Net-Zero scenario (CNZ) in its report *Canada's Energy Future 2023*.[19] There are a number of problems with using the CNZ to justify the proposed upper legal limit.

The most obvious is that the CER itself cautions against using the scenarios in this way:

> The results in EF2023 are not predictions about the future, nor are they policy recommendations Rather, they are the product of scenarios based on a specific premise and set of assumptions. Relying on just one scenario to understand the energy outlook implies too much certainty about what could happen in the future.[20]

But equally importantly, the modelling used for the Canada and global net-zero scenarios assume that the oil and gas emissions cap will be set at 31% below 2005 levels, the level specified in Canada's Emissions Reductions Plan (ERP).[21] The modelling allows for "two years of flex time in meeting the 2030 target to account for the length of time large-scale infrastructure like carbon capture, utilization, and storage (CCUS) takes to develop," but otherwise does not assume there will be compliance flexibilities that would allow emissions to exceed the cap level.

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[15] ***R v Hydro-Québec,* 1997 CanLII 318** at para 154.
[16] *Reference re Firearms Act*, *supra note 7* at para 27; *Reference re Genetic Non-Discrimination Act*, *supra* note 11 at para 67.
[17] *R v Hydro-Québec, supra* note 15 at para 127.
[18] *Reference re Genetic Non-Discrimination Act, supra* note 11 at para 68.
[19] Canadian Energy Regulator, ***Canada's Energy Future 2023***.
[20] *Ibid* at page 4.
[21] *Ibid* at page 118.

In other words, the Framework appears to rely on modelling that assumes a cap of 31% reductions in oil and gas emissions relative to 2005 levels, with limited flexibility for the industry, to justify a cap of 16-20% below 2005 levels (35-38% below 2019 levels) with a wide range of compliance flexibility. If the upper legal limit were to align with the CNZ, it should be equivalent to 31% below 2005 levels.

However, even the 31% reduction goal set by the ERP and assumed by the CER is a political compromise that allows the oil and gas industry to do less than its fair share towards meeting Canada's climate target of 40-45% below 2005 levels.

The proposed emission cap target, even without flexibility mechanisms, would require other Canadian sectors to collectively reduce their emissions by between 10 and 24 MT above their fair share in order to achieve Canada's stated goal of 40-45% below 2005 levels. In our view, it is unreasonable and unrealistic to require other Canadian sectors to do more while the oil and gas industry does less.

No Compliance Flexibilities

Recommendation 3: Do not allow compliance flexibilities such as ITMOs, offsets or the proposed decarbonization fund.

The oil and gas emissions cap must be that – a cap on emissions. Put simply, compliance flexibilities like offsets risk undermining the effectiveness of the cap, by reducing the price signal or even allowing for expansion of emissions. In many cases, they can lead to false solutions on which we cannot afford to waste more time. For example, the vast majority of available offsets do not operate on the timescale that CO_2 emissions from fossil fuels operate on,[22] meaning that they cannot "lock away" the carbon released by the burning of fossil fuels for as long as they need to be in order to avoid the most catastrophic impacts of climate change.

Internationally transferred mitigation outcomes (ITMOs) are similarly problematic. The rules on Article 6.2 of the Paris Agreement governing ITMOs have not yet been made and there is an unacceptable risk that ITMOs would not represent actual emissions reductions. Additionally, if Canada were to pass the costs of ITMOs on to facilities, taxpayers would be effectively subsidizing loopholes for industries like LNG, an unacceptable proposition.

The decarbonization fund is especially problematic as it would not reflect actual emissions reductions. While we support the proposition that oil and gas facilities pay into a decarbonization fund – either to help fund reductions in other sectors or to serve as a "rainy day" fund in the even that a depression in the oil and gas market makes it more difficult for facilities to afford to continue reducing their emissions along the necessary trajectory – that fund cannot be used by facilities to claim credit for emissions reductions they have not actually achieved.

The goal of the emissions cap must be to reduce emissions, not to establish loopholes that allow industry to avoid reducing them.

[22] Wesley Morgan, "**A tonne of fossil carbon isn't the same as a tonne of new trees: why offsets can't save us**" (9 March 2023: The Conversation); The Climate Council, ***Land Carbon: No Substitute for Action on Fossil Fuels*** (2016).

Apply a Broad Scope

Recommendation 4: In addition to the facilities and associated activities outlined in the Framework, the cap should apply to all oil and gas storage and distribution facilities and their upstream pipelines, including marine shipping.

The scope of the proposed emissions cap is too narrow to reasonably ensure that Canada meets its climate targets. As we argued in our **2022 submission**, to be effective the cap must be comprehensive in scope, applying to all oil and gas facilities, including refineries, pipelines and liquefied natural gas facilities. It is unclear why the cap would not apply to high-emitting projects like the Trans-Mountain pipeline or the emissions associated with the marine shipping of LNG and oil.

Recommendation 5: There should be no grace periods for new facilities.

It is also unclear why new facilities would not be required to comply with the cap once they are in operation. Exempting them for an initial grace period would simply add to the sector's uncovered emissions. Particularly problematic would be tying the timing of the first compliance period to the achievement of a proportion of design capacity, as it could encourage facilities to 'game the system.' For example, proponents of new facilities could simply set a higher design capacity and keep emissions just below that capacity in order to avoid being subject to the cap.

A similar practice is commonly used to avoid environmental and impact assessments: proponents frequently design projects just under the threshold at which an assessment would be required, and often incrementally expand their projects (also below the assessment thresholds) until projects are far larger than what would have initially triggered an assessment. To avoid the risk of facilities finding ways to bypass the cap, all facilities should be covered immediately when they come online.

Allocate Allowances through Auctioning

Recommendation 6: Establish an auction for emissions allowances. If emissions are freely allocated for an initial transition period, minimize that period and require all new facilities to purchase their allocations.

We firmly believe that polluters must pay for the pollution they cause. The polluter pays principle is a core principle of both International and Canadian environmental law that says polluters should not get a free pass on their pollution. While some facilities will be covered by both the carbon tax and the emissions cap, most large oil and gas emitters only pay a fraction of the carbon tax.[23]

Reviewing the Cap Trajectory

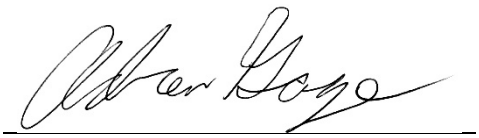
Recommendation 7: Require reviews of the regulation in accordance target-setting under the *Canadian Net-Zero Emissions Accountability Act* (CNZEAA).

Section 7(4) of CNZEAA requires the Minister to set emissions targets five years in advance, taking into account the factors set out in section 8. To help ensure that the emissions cap levels reflect the oil and gas sector's share of the national target, the emissions cap regulation should require reviews within six months of when the Minister sets a target under section 7(4) of CNZEAA, and should require the

[23] Yannic Rack, "**Canada's biggest emitters are paying the lowest carbon tax rate**" (17 January 2022: Corporate Knights); Canadian Institute for Climate Choices, ***2020 Expert Assessment of Carbon Pricing Systems*** (2021: Environment and Climate Change Canada).

Minister to amend the cap levels to ensure that the sector's emissions align with the national target. The regulation should also require the Minister to seek the advice of the Net-Zero Advisory Body when undertaking those periodic reviews and establishing new cap levels. Revisions or updates to the target and regulations can then be reported in the key measures that the Minister must report on under section 7(5) of the Act.

Sincerely,



Andrew Gage
Staff Lawyer

Anna Johnston
Staff Lawyer