



## EU METHANE REGULATION: REDUCING EMISSIONS IN THE ENERGY SECTOR

On 4 August 2024, Regulation (EU) 2024/1787 on the reduction of methane emissions in the energy sector (EU Methane Regulation) entered into force. The Regulation includes the first-ever EU rules to curb methane emissions from the energy sector in Europe and across the world. It requires the fossil gas, oil and coal industry in Europe to monitor, report and verify their methane emissions and to take action to reduce them and applies to *importers, operators and undertakings*. This briefing takes a look at key aspects of the Regulation.

### METHANE AND EU INITIATIVES

Methane is the second most important greenhouse gas contributor to climate change following carbon dioxide, accounting for about 16 percent of global emissions. Methane is approximately 28 times as potent as carbon dioxide at trapping heat in the atmosphere. The annual increase in methane concentration from 2020 to 2021 was the highest on record and levels continued to increase in 2022. Since methane is both a powerful greenhouse gas and short-lived compared to carbon dioxide, achieving significant reductions would have a significant effect on its atmospheric warming potential. In view of achieving the 2050 climate objectives of the EU, it is therefore essential to reduce methane emissions.

The EU Methane Regulation is a key part of the EU initiatives, including the European Green Deal and Repower EU, aimed at tackling greenhouse gas emissions. The overall aim of the Methane Regulation is to increase transparency on emissions.

### EU METHANE REGULATION AT A GLANCE

The EU Methane Regulation (the Regulation) is particularly crucial to delivering the EU Methane Strategy. The Regulation applies to *importers, operators and undertakings* and aims to stop the avoidable release of methane into the atmosphere, both in the EU and in the EU's global supply chains, and to minimise leaks of methane by fossil energy companies operating in the EU.

More specifically, the Regulation stipulates monitoring, reporting, and verification obligations, a ban on routine venting and flaring, mandatory leak detection and repair, a methane transparency requirement on imports, a rapid reaction mechanism for super-emitting events and additional specific rules regarding methane emissions from imported fossil energy.

#### Key issues

- The Regulation aims to reduce methane emissions from oil & gas extraction and distribution, and coal mining operations, and from related assets.
- Key obligations provide for:
  - monitoring, reporting, and verification of methane emissions;
  - a ban on routine venting and flaring;
  - mandatory leak detection and repair; and
  - methane transparency requirement on imports, and additional specific rules regarding methane emissions from imported fossil energy.
- Financial implications may be significant in terms of capital requirements of compliance, or penalties for non-compliance which may include penalties based on turnover.

## What is required from importers?

The Regulation focuses in particular on imported crude oil, natural gas and coal, so that importers are specifically addressed by the Regulation: Starting in 2025, companies will be required to report annual methane emissions data, including emissions from third countries and companies exporting to the EU. As from January 2027, the Regulation will impose stricter obligations, mandating that new import contracts for oil, gas, and coal can only be concluded if exporters are subject to the equivalent monitoring, reporting, and verification requirements to those imposed on EU producers. For all contracts concluded with exporters to the EU after the entry into force of the Regulation (4 August 2024), EU importers will have to:

- provide limited information to the Member State in which they are established (**as of 4 August 2024**). This information should include details about the exporter and producer, as well as the measures they have taken to monitor and reduce methane emissions. If the exporter and/or producer has methane emissions reports, these should also be provided and the reports are not required to meet any prescribed standards at this stage (**Phase 1**).
- demonstrate (**as of 1 January 2027**) that the concerned producers are subject to monitoring, reporting and verifying methane emissions that are equivalent to the requirements of the Regulation (**Phase 2**).
- report (**from 5 August 2028**) on the methane intensity of the production of oil, gas and coal that they are placing on the EU market, in line with a methodology to be later set out by the Commission in secondary legislation (**Phase 3**).

For those contracts concluded after 5 August 2030, EU importers will have to demonstrate that the methane intensity of the production of oil, gas and coal imported into the EU market is below certain maximum values, to be set by the Commission at a later stage in secondary legislation (**Phase 4**).

Throughout these phases, the requirements for importers will become more stringent, with increasing obligations and monitoring.

For contracts entered into before the Regulation importers must make all reasonable efforts to ensure these contracts comply with the Phase 2 reporting requirements as from 1 January 2027.

Penalties will have to be set by the national authorities in the Member States at levels that are effective, proportionate and dissuasive. While it is possible that Member States could impose bans for failure to comply with these provisions, this seems unlikely since the Regulation requires them, in imposing penalties, to preserve security of supply (cf. article 33(2)).

### Practical implications for importers

In view of the described requirements and phases, supply contracts relating to deliveries after 4 August 2024 must include provisions to ensure compliance with monitoring, reporting, and transparency obligations. This necessitates a thorough review and potential amendment of existing contracts to incorporate these new regulatory requirements. Importers must ensure that their contracts are aligned with the Regulation's phased approach to avoid potential penalties and ensure a smooth transition to compliance.

For longer-term contracts entered into before the Regulation takes effect but with delivery dates after 4 August 2024, importers must make all reasonable

efforts to ensure these contracts comply with the **Phase 2** reporting equivalence requirements, which applies from 1 January 2027. This and the following phase emphasise the importance of transparency and accurate reporting, necessitating detailed contractual provisions to ensure compliance.

By 5 August 2028, importers will need to negotiate appropriate clauses in their supply contracts, including those that predate the Regulation, and make all reasonable efforts to bring these contracts into compliance with **Phase 3**, which requires sellers to provide methane intensity information.

Monitoring, Reporting, and Verification (MRV) clauses should be added to contracts. This could be enacted in the following two ways:

- **Light MRV Clauses:** These clauses impose obligations without consequences for non-compliance. They are relatively straightforward to negotiate in new contracts, provided the parties understand the Methane Regulation's requirements and the exporter is willing to accept such provisions. However, incorporating these clauses into existing contracts is more challenging, as it requires mutual agreement from both parties and potentially project lenders. Light clauses can serve as an initial step towards compliance, allowing parties to gradually adapt to the new regulatory landscape.
- **Detailed MRV Clauses:** These clauses include both the underlying obligations and consequences for non-compliance, such as fines or the right to refuse a cargo. Importers may seek indemnification from sellers/exporters for any sanctions imposed due to non-compliance. However, the inclusion of detailed clauses is complicated by uncertainties surrounding the Commission's proposed MRV methodology, the robustness of upstream data, and potential challenges identifying whether producer MRV methodologies are equivalent to EU requirements and how equivalence needs to be demonstrated. Sellers may be reluctant to agree to detailed clauses if they have alternative buyers without similar requirements, posing a risk to EU energy supply security. Detailed provisions will give a more robust framework for compliance but require careful negotiation to balance the interests of all parties involved.

After 5 August 2030, the Regulation does not explicitly require importers to make reasonable efforts to bring older contracts into alignment with the Regulation, which implies that there is no obligation to renegotiate them to comply with **Phase 4** requirements. However, there is likely to be stakeholder pressure to do so, and therefore, importers should from a practicable perspective continue their efforts to ensure compliance.

## What is required from operators and undertakings?

### *Monitoring, reporting and verification obligations of operators and undertakings*

Oil, gas and coal companies across the supply chain will have to monitor, report and verify their methane emissions according to the highest standards, and act to reduce them (cf. articles 12, 13, 20, 25). The Regulation requires companies to quantify methane emissions at source level (such as wells) for oil, gas and coal and at site level for oil and gas. Operators must submit each year a methane emissions report to the national competent authorities in the EU Member States where their assets are located. The failure to submit the methane emissions reports results in a penalty (cf. article 33).

### *Ban of routine venting and flaring*

Article 15 requires EU gas, oil, and coal operators to stop avoidable and routine flaring, limiting it to emergencies, technical malfunctions, or safety reasons. Gas re-use or recovery is prioritised over flaring and flaring over venting. Article 16 mandates reporting of venting and flaring events, while Article 17 sets a flaring efficiency requirement of at least 99%.

### *Mandatory leak detection and repair*

Article 14 mandates that EU gas and oil operators take all possible measures to prevent or minimise methane emissions. Operators must regularly survey and repair methane leaks and submit their Leak Detection and Repair (LDAR) programmes to authorities by 5 May 2025 for existing sites, or six months for new sites.

*Rapid reaction mechanism for super-emitting events:* The Commission will establish a rapid reaction mechanism to address "super-emitting" events, where facilities, equipment, or infrastructure emit very high rates of methane (cf. article 31).

## **Penalties**

Potential risks in the case of non-compliance with the Regulation's requirements could result in financial penalties and in losing access to the EU market. Article 33 of the Regulations establishes a framework of financial penalties for non-compliance, rather than imposing a ban on imports of LNG from offending producers or importers. Each Member State is responsible for implementing these penalties, which are designed to be effective, proportionate, and dissuasive. The penalties can include fines and periodic penalty payments, tailored to the type and gravity of the infringement, the potential advantage gained by the operator, and the environmental damage caused – provided that the penalties do not endanger the security of energy supply. The Regulation mandates that Member States ensure penalties are imposed for specific infringements, such as failure to comply with reporting requirements or maximum methane intensity rules.

Notably, the Regulation sets a maximum fine of 20% of the previous year's turnover of the sanctioned entity for the breach of key provisions relating to imports. However, while the Regulation allows Member States to determine the quantity of the fines, it remains unclear whether the turnover considered for fines is limited to the legal entity in breach or extends to the wider corporate group. Additionally, the potential for emission offsets to mitigate fines is uncertain, as the Regulation does not address this possibility.

## **Impact on transparency and contracts for traders / risk**

### **Methane Transparency Database and global methane monitoring tools**

Based on information provided from the reporting under the Regulation, the European Commission will establish a Methane Transparency Database. It will also create monitoring tools based on various data sources. The database and global monitoring tools will be pivotal in providing a comprehensive overview of methane emissions across different sectors. These resources will enable stakeholders to track emissions in real-time, identify major sources, and assess the effectiveness of mitigation strategies. For businesses, this means that there is a greater emphasis on accountability and the need to demonstrate compliance with environmental standards. The data from these resources can be used to benchmark performance, set reduction targets, and

report progress to regulators and investors. This level of transparency is crucial for building trust with stakeholders and ensuring that companies are meeting their environmental responsibilities.

More generally, from a global perspective, the EU is arguably well ahead of other regions importing oil, gas and coal in terms of demanding and publicly sharing data on the emissions intensity of these fossil fuels.

### **Financial Implications**

The financial implications of the Regulation are poised to be substantial for companies operating within the affected sectors. One of the primary financial impacts will be the increase in capital expenditure due to the necessity of investing in advanced monitoring equipment. Companies will need to allocate significant resources to upgrade or retrofit existing facilities to minimise methane emissions, which may require substantial capital outlay. These costs can be substantial, particularly for smaller companies or those with extensive supply chains. This investment is crucial for ensuring compliance with the regulation but represents a considerable financial commitment.

Additionally, the Regulation will impose an increased administrative burden, as companies will need to enhance their compliance reporting processes. This will likely lead to higher operational expenses, as businesses may need to hire additional staff and/or invest in new systems to manage the increased reporting requirements effectively. Furthermore, the availability of emissions data could influence market dynamics, particularly concerning the diversion of cargoes to the EU market. Companies may face challenges if their emissions data does not meet the stringent requirements of the EU, potentially limiting market access.

The Regulation could also lead to a division in the market, distinguishing between "EU Methane Regulation-Compliant" LNG and LNG that does not adhere to these standards. This division could have significant financial implications, as compliant LNG may command a premium price due to its adherence to stricter environmental standards. Conversely, non-compliant LNG may face reduced demand or be restricted to markets with less stringent regulations. This bifurcation could influence pricing strategies, market access, and competitive positioning within the global LNG market.

### **AMBIGUITY AND QUESTIONS RAISED**

The Regulation introduces several areas of ambiguity that pose challenges for stakeholders seeking to ensure compliance. These uncertainties primarily stem from the broad and sometimes vague definitions of key terms and roles within the Regulation. The lack of precise language leaves room for varied interpretations, which can lead to inconsistencies in how or when the Regulation is applied across different jurisdictions and sectors.

### **Importers and producers**

Article 1(3) imposes an obligation on importers who are defined under article 2(59) as 'a natural or legal person who, in the course of a commercial activity places crude oil, natural gas or coal originating from a third country on the Union market'.

This concept of 'placing on the market' is pivotal in determining the scope of the Regulation's applicability, yet it remains ambiguous whether it pertains solely to entities physically importing goods into the EU or extends to traders who do not manage physical assets? Recent guidance from the Commission

suggests that the obligations will only relate to physical imports to the EU, a similar approach to regimes such as the REACH chemicals Regulation.

Under Article 2(58), a 'producer' is defined as *'an undertaking which, in the course of a commercial activity, produces crude oil, natural gas or coal by extracting it from the ground in a licensed area, processing it or conveying it through connected infrastructure within that licensed area'*. This definition introduces ambiguity, as it may apply to different entities based on the specific configuration of an LNG project. The term 'licensed area' remains undefined in the Regulation, raising concerns that it could be strategically interpreted by projects to exclude certain activities from methane intensity calculations, thereby potentially reducing their regulatory obligations.

## **Verification**

The Regulation's approach to verifying methane emission intensity is critical, yet it lacks clarity, which could lead to discrepancies in how emissions are measured and audited across different Member States. This lack of standardisation raises concerns about the accuracy and comparability of data, potentially undermining the Regulation's objectives. Questions arise about the role of third-party verifiers and the criteria for their accreditation, as well as the frequency and scope of audits required to ensure compliance. These uncertainties necessitate clearer guidelines to establish a robust and uniform verification process, ensuring that all stakeholders adhere to the same standards and methodologies.

## **Impact on commercial terms**

The question of how these regulatory requirements will shape commercial terms and the day-to-day business of the global trade of fossil fuels remains unresolved. In particular, The Regulation does not contain explicit provisions specifying when exactly companies need to start collecting the data required for the new contracts. This uncertainty extends to commercial transactions in general, leaving open the question of whether, and when, data on emissions intensity will become available for specific commodities, such as LNG cargoes or discrete pipeline volumes. Furthermore, it remains unclear whether the market will start to assign a premium to fossil fuels with lower emissions intensity, potentially reshaping pricing structures and competitive dynamics within the industry. As companies navigate these regulatory changes, the timing and availability of emissions data will be crucial in determining their strategic and operational responses.

## **OUTLOOK**

Oil, gas and coal companies across the supply chain will need to ensure compliance with the new EU methane reporting and mitigation requirements. In order to prepare for the Regulation coming into force, and mitigate regulatory risk, companies should consider establishing internal methane reporting procedures and governance structures, particularly to store and analyse data for methane reporting. Furthermore, EU importers will have to assess, and where necessary, revise their contracts to ensure compliance with monitoring, reporting and verification obligations

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