

POLICY NOTE

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# EU Methane Regulation

*Penalties are not a compliance design*

*Why importer penalties cannot substitute for a workable  
methane-compliance architecture*

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## Core message

The debate on the EU Methane Regulation has been drawn too narrowly to the question of importer penalties. The focus is understandable, but it obscures a more fundamental point: penalties, no matter how high or how low, are not a compliance design. They are merely the consequence of the absence of compliance.

A well-calibrated penalty can deter misconduct, but it cannot, on its own, create the operational, contractual and market conditions that make compliance feasible. For imported oil, gas, LNG and coal, the decisions that determine methane performance — measurement, reporting and verification, leak detection, the reduction of venting and flaring, and the quality of the underlying data — are all taken upstream. EU importers do not control them.

If the Union intends to influence upstream methane behaviour, it must offer producers a mechanism they can observe, price and act upon. A downstream penalty levied on an importer is not such a mechanism.

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*Liability falls downstream — but the abatement decisions are taken upstream. No price, no contractual lever, no economic signal crosses that gap.*

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## Why penalties do not create a usable pricing signal for upstream producers

The problem is not simply that penalties may be set too low. The deeper issue is structural: a penalty cannot produce a bankable price signal for producers unless it is transmitted through a clear, predictable and monetisable commercial mechanism. In the present design of the Regulation, that transmission is missing.

The point can be put in plain terms. If the EU intends to influence what happens at the wellhead, the producer must be able to see a value for performing well and a cost for performing badly. A penalty applied to an importer does neither. The eight observations that follow explain why.

- **First — the penalty is not paid to the producer.** A fine imposed by a Member State on an EU importer generates no revenue for the upstream company that would actually have to invest in

measurement, reporting and verification (MRV). The producer sees no premium for better methane performance and therefore has nothing against which to weigh the cost of an MRV upgrade.

- **Second — the penalty is not attached to a tradable commodity attribute.** For a price signal to be usable, methane performance must be capable of being priced separately, bought, sold and retired for compliance. A penalty does none of this. It puts a cost on non-compliance but it does not put a positive price on verified compliance. Upstream players see no observable market curve for "MRV-compliant" or "low-methane" supply.
- **Third — the penalty is legally uncertain and nationally fragmented.** Penalties under EU regulations are typically implemented and enforced by Member State authorities. If enforcement intensity, calculation methods or administrative discretion vary across jurisdictions, the signal that ultimately reaches the producer is heterogeneous and uncertain. A patchwork of twenty-seven downstream enforcement risks cannot serve as the basis for a global investment decision.
- **Fourth — the penalty does not necessarily reach the producer's netback.** Even where an importer is fined, it may absorb the cost, pass it through to consumers, hedge it via portfolio management, reduce its exposure to specific contracts, or rely on generic contractual protections. None of these outcomes guarantees that the producer receives a clear negative adjustment for poor MRV or a positive premium for strong MRV. The cost dissipates downstream before it can travel upstream.
- **Fifth — the penalty is episodic, not investable.** Upstream methane reduction requires sustained capital and operating expenditure: measurement systems, third-party verification, continuous monitoring, process changes and ongoing maintenance. Such investments depend on a durable revenue expectation over many years. A possible future fine on a buyer, applied case by case, is not an investable income stream — no investment committee and no lender will underwrite a project against it.
- **Sixth — the penalty may encourage avoidance rather than improvement.** Where compliance evidence is unclear, importers will tend to avoid certain suppliers or contract structures, not because methane performance is necessarily poor, but because the documentation is insufficient to satisfy the EU authority. This narrows liquidity and supply optionality without giving the producer any mechanism to monetise better data or genuine improvements at the asset.
- **Seventh — global commodity markets dilute the signal.** Oil, gas, LNG and coal are traded in global markets. A producer selling into multiple destinations will not overhaul its MRV systems merely because one downstream jurisdiction imposes modest penalties on some of its buyers, unless it can capture a reliable premium in return. In the absence of a recognised certificate or attribute market, the EU penalty becomes one compliance variable among many — not a decisive investment signal.

- **Eighth — penalties are essentially unpriceable at the point of contracting.** Fines typically materialise long after a contract has been entered into, in forms that can scarcely be anticipated at the negotiating table. The seller has every incentive to demand a price that reflects the maximum theoretical liability before agreeing to deliver compliant volumes; the buyer is willing to pay only at a much lower level, confident that it can extract a softer outcome from its competent authority. The two positions cannot be reconciled. The penalty is therefore unpriceable in any meaningful commercial sense.

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*A low penalty generates enough legal risk to disturb trade flows, but not enough economic value to alter upstream behaviour — friction in EU markets without atmospheric improvement.*

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## Reframing the debate

The right question is not "penalties or no penalties". It is whether the Regulation gives market participants a practical route to compliance and provides producers with a commercial reason to improve.

A low or uncertain penalty risks becoming little more than a cost of doing business — absorbed, passed through, litigated, hedged contractually, or side-stepped through supply selection. None of these outcomes builds a methane-performance market, and none finances upstream abatement.

A time-bound, conditional period of enforcement flexibility may therefore be preferable to premature reliance on weak penalties — provided the interval is used deliberately to construct the compliance mechanism that the Regulation presently lacks.

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## A better architecture: tradable methane-performance certificates

The EU should recognise separately tradable methane-performance certificates as a compliance instrument, thereby converting verified methane performance into a marketable attribute.

The logic is straightforward. A producer that invests in credible MRV and methane reduction generates a certificate; an importer required to demonstrate compliance purchases and retires it; the certificate price becomes the economic signal that penalties cannot deliver.

This achieves what enforcement alone cannot. It makes methane performance visible, valuable and investable.

- It rewards producers for verified performance, rather than only punishing importers for its absence.
- It establishes price discovery for methane performance.
- It gives producers a bankable basis for investment decisions.
- It accommodates the fungible and global nature of commodity markets.
- It rewards early movers and encourages others to improve MRV and abatement.

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## Design principle: broad start, strict standards, tighter alignment over time

For the certificate market to function, it must first become liquid. The EU should therefore permit broad initial usability of verified certificates, while applying rigorous integrity standards from the outset.

The starting point is breadth of geography, not laxity of standards. Certificates should be subject to robust verification, recognised auditors, transparent methodologies, registry controls, vintage rules, retirement requirements and protections against double counting.

Once the market has taken shape, the link between certificates and physical import flows can be progressively tightened.

- **Phase 1 — Global usability.** Certificates from any verified producer are eligible, in order to build liquidity and price discovery.
- **Phase 2 — National matching.** Certificates must be linked to the country of supply, save where an equivalence or mutual-recognition arrangement applies.

Such sequencing would allow the Union to begin with a functioning market and move, in time, toward closer alignment between compliance instruments and physical supply.

## Recommended policy position

Penalties should be retained in the Regulation, but their function should be precisely understood. They protect the integrity of the compliance system; they do not constitute the system itself.

They are well-suited to addressing fraud, deliberate non-reporting, misrepresentation, double counting, misuse of certificates, failure to retire recognised instruments, and the wilful disregard of obligations. They are far less effective when invoked to punish an importer for failing to compel a third-country producer to alter its operational practices.

The Union should therefore adopt a package built around:

- time-limited enforcement flexibility during the initial MRV build-out;
  - recognition of separately tradable methane-performance certificates;
  - an EU-recognised registry, or an interoperable network of registries;
  - strict rules on verification, issuance, transfer, vintage and retirement;
  - initial global usability to foster liquidity and price discovery;
  - a pre-announced transition toward country-based matching constraints; and
  - penalties focused on misconduct and on failures to comply with the certificate system itself.
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## Conclusion

Penalties are not a compliance design; they are the consequence of the absence of compliance. The distinction is not semantic. It is structural — and it is essential to the success of the EU Methane Regulation.

Importer penalties may create legal exposure for EU buyers, but they do not generate a usable signal for the producers whose investment in measurement, reporting, verification and abatement is the actual policy objective.

If the Union genuinely wishes to alter upstream behaviour, it must put in place a mechanism that producers can observe, monetise and build investment decisions around. Tradable methane-performance certificates can provide that mechanism. Penalties should enforce the integrity of the system — not stand in for it.

