

Revitalizing Oil and Gas

The Alberta Liberal Caucus Plan for Stability
and Prosperity in the Oil and Gas Sector



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Introduction

The Official Opposition is pleased to share our new Oil and Gas policy, approved by the Alberta Liberal Caucus in January 2010.

This policy is the culmination of a year-long consultation process with people inside the oil and gas industry. Recognizing that the oil and gas sector is the backbone of Alberta's economy, and that the sector is hurting, we wanted to determine what we would do if we were government; that is, how we would craft sound energy policies resulting in a robust oil and gas sector, a healthier environment, and good jobs for Albertans.

At the time, nobody was actually sitting down to talk with the industry to find out what they needed in order to prosper in Alberta.

We found out that what the sector needs above all else is certainty. Unfortunately Ed Stelmach's royalty review process provided nothing but uncertainty, and every patch-up job since then only added to the instability. As a result, investors have been taking their money elsewhere.

Challenges to the oil and gas sector mean challenges for all Albertans. Those challenges will be met far more effectively if government and industry work in partnership rather than at cross purposes.

That doesn't mean that government and industry will always see eye-to-eye; both will come to the table representing different interests. But it does mean that all parties at the table will be committed to a win-win resolution every time.

We are grateful to the many representatives of the oil and gas industry who took the time to meet with us as we developed this policy. Alberta Liberals look forward to a better, stronger, more productive relationship with Alberta's most important industry.

A handwritten signature in black ink, appearing to read 'David Swann', with a large, stylized initial 'D'.

David Swann, Leader of the Official Opposition

Our relationship with the oil and gas industry is vital. Alberta's oil and gas resources belong to the people of Alberta, and we rely on the industry to develop those resources. The oil and gas industry is the backbone of Alberta's economy. With that in mind, over the last several months we have consulted in detail with members of the oil and gas industry. We have offered proposals, we have asked for suggestions, and we have listened to their advice.



The Principles

Our consultations have led us to five principles:

One. That the health of the Alberta economy is inextricably tied to the health of the energy industry;

Two. That the Alberta Liberals view the energy industry as a positive force in Alberta;

Three. That the energy industry requires certainty, sustainability, consistency and effectiveness in regulation and policy;

Four. That energy policy and royalty rates should be determined in consultation with the industry, be based in fact, and be competitive;

Five. That a responsible government and the Alberta energy industry will work together to ensure good stewardship of the environment.

Defining The Process

We believe the process of developing sound energy policy must include the following:

- ▶ both industry and all other interested and affected parties must be consulted on an ongoing basis and at every stage of policy development, and their perspectives taken seriously
- ▶ policy must reflect an understanding of the industry's need for an adequate return on investment, that reflects the level of risk undertaken.
- ▶ policy must reflect an understanding of the industry's need for stability, certainty and the need to be competitive on a global scale
- ▶ policy must balance the recognition of the importance of a healthy energy industry with that of taking responsibility for climate and the environment
- ▶ policy must commit industry, government and the people of Alberta in partnership to continuous improvement in clean energy, conservation, and reduction of our environmental footprint
- ▶ policy and regulations must be effective, efficient, consistent, and based in fact

A number of factors contribute to today's economic challenges in Alberta generally and the energy industry specifically. Many of those factors have been largely beyond our control – the US economic meltdown, global recession, commodity prices, and the strong Canadian dollar, as well as the lingering effects of worldwide

construction cost inflation, a higher cost structure on gas in Alberta including the cost of transporting the product long-distance to market, and changes to the North American gas market brought about by a huge increase in supply.

But some factors are within our control – royalties, incentives and regulations.

Royalties and Resource Revenues

The royalty review process was flawed from the outset; the resulting “royalty reform” has been patched over so many times that it’s hard for anyone to fully understand it. This lack of certainty makes it difficult to plan for the medium and long term. Alberta’s long-standing reputation for fiscal stability has been seriously damaged in just two years.

Further, the royalty review failed to take into consideration that royalties are just one of a number of sources of provincial revenue derived from the energy sector, with others such as land sales ignored.

We understand that there are two ways to fix this – the right way, and the wrong way. Any attempt at a “quick fix” is undoubtedly the wrong way. The right way is:

- ▶ Government will sit down with the energy industry and the financial industry to define a process for setting royalties that are competitive and allow for a return on investment.
- ▶ This determination will take into account the full spectrum of government revenue generated by the energy industry.
- ▶ We would consider using the royalty system as an incentive to encourage lower environmental impact behaviours.



Regulatory Reform

Alberta used to pride itself on having the best regulatory framework of any oil producing jurisdiction. It allowed the oil and gas industry to succeed while providing a level of environmental protection second-to-none among oil producing regions. And it did so, efficiently.

Of late, however, what was once an efficient and effective regulatory system has become cumbersome. What used to take a year to get regulatory approval now takes three years.

We want to commit to Alberta remaining the environmental and regulatory world leader in oil and gas, while at the same time improving regulatory efficiency and providing regulatory certainty.

- We would have a simplified regulatory system with a quicker, more effective process.
- We would ensure that the resources of the ERCB are deployed to the maximum effect.
- We would institute a one-window approach to approvals, permits, inspections, etc.
- We would improve co-ordination on oil and gas matters between the ERCB, Alberta Environment, Alberta Energy and Alberta Sustainable Resource Development, and also with the Federal Government and First Nations.

Infrastructure

The energy industry has created great wealth for Alberta, but during the boom it also had a negative impact on municipalities and regions where intensive oil and gas activity overwhelmed the existing infrastructure. Municipal governments argue that it is unfair that they should have to pay to repair and rebuild public infrastructure damaged by excessive wear and tear due to oil and gas activity.

- Where infrastructure is demonstrably related to industry activity, we would work with industry to determine their appropriate funding contribution.

Distinctions Within the Oil and Gas Sector

Although the characteristics are blurring somewhat with the use of non-conventional techniques on what is considered conventional production, it is important to understand the distinctions between conventional gas, unconventional gas, conventional oil, and the oil sands.

Conventional Gas

The conventional gas business is in a world of pain today. Very low prices, lingering high costs, and a strong Canadian dollar are contributing to a dramatic decline in natural gas drilling activity. Additionally, the conventional gas business is hampered by a cost structure that is higher than in the United States – smaller resource, smaller wells, smaller service sector, difficult locations, difficult weather and the extra \$1/mcf cost to transport the gas to market because of distance all contribute. Add in the ill-designed royalty structure and conventional gas in Alberta is no longer competitive.



Natural gas is responsible for 70% of the drilling activity in Alberta's energy sector, and each rig creates in excess of 100 direct jobs and a spinoff effect throughout local economies **all across the province** – from Grande Prairie to Medicine Hat. Many of those rigs, jobs, and economic spinoffs have left Alberta and relocated elsewhere in Canada, the US, and globally. The exploratory well count is the lowest in more than 20 years, and the decline in spending on crown leases has effectively erased any royalty gains.

Conventional gas in Alberta is very mature, with at least a 20% annual decline in production. We believe Alberta has to take this into account in designing its royalties and incentives to preserve the ongoing viability of the sector for as long as possible, similar to the UK North Sea.

- ▶ We would take into account the mature state of Alberta's conventional gas reserves in designing its royalties and incentives with the goal of preserving the ongoing viability of the sector for as long as possible.
- ▶ One option we would consider is to start royalties low, raising them as risk is reduced and costs come down, and then reducing them as production wanes to encourage protracted development.

Unconventional Gas: Tight Gas, Shale Gas, Coal Bed Methane (CBM)

Unconventional gas takes sophisticated technology to unlock and a big investment to develop – often in the neighborhood of \$10 million for a single well. While economies of scale can eventually bring the cost per well down significantly, unconventional gas still requires significant upfront expenditures.

Along with oil sands, unconventional gas is the future of oil and gas development in Western Canada. It is a huge prize. BC's Horn River Basin is the second biggest shale gas unconventional basin in North America, according to some estimates. Unconventional gas is now the second biggest income generator for BC in terms of lease and license payments.

Alberta has extensive unconventional gas resources including the Montney Play – not as big as the Horn River Basin, but big enough to be competitive **provided Alberta has a competitive structure for unconventional gas development**. But today, we do not.

- ▶ We would rework royalties on unconventional gas so that government is not maximizing its "take" on the front end, when development costs are the highest.



- We also recognize the need to be competitive with other jurisdictions, while being careful not to get caught in a race to the bottom.
- To better enable development of unconventional natural gas resources in northwest Alberta, we would ensure that the appropriate infrastructure is in place, either by directly building it with public funding, or by incentivizing industry to do so privately.

Conventional Oil

We still have some conventional oil reservoirs, and there is the potential to renew production in older reservoirs. For every barrel of conventional oil that has been or can be produced, 2 barrels remain in the reservoir. Tertiary recovery is an advanced technology with great potential to extract more oil.

One method involves injecting CO₂ into the reservoir for enhanced oil recovery, which presents an opportunity to both capture and remove CO₂ out of our environment and at the same time to increase oil production on which Alberta earns a high royalty. The Alberta government has recently announced a plan to use captured CO₂ for enhanced oil recovery. On the face of it, it looks like a good idea – at reasonable cost, the province would partner with pipelines and producers to build a CO₂ distribution network, so CO₂ can be shipped from the industries that produce it to the oil fields that can use it. The province’s investment would be recouped from future oil royalties. But it will require a commitment from the CO₂ producer to deliver, a commitment from the oil and gas producer to take CO₂, and proposals from resource owners for CO₂ storage reservoirs.



Unconventional oil development will become an increasingly important part of the Alberta oil and gas industry in the future, and we want to encourage that development. Unconventional or tight oil refers to low permeability reservoirs. The Bakken in Saskatchewan is the best-known today; Alberta has the Cardium and Viking plays and others will follow.

Tight oil involves horizontal wells and multi-stage fracturing – the same sophisticated and high-cost technology required to unlock unconventional natural gas. At the same time, we recognize that the worldwide oil market and the North American gas markets are very different. Consequently, it may be possible to treat tight oil in the same way as conventional oil in relation to royalties.

- Recognizing the costs of further development, we would institute a royalty system and a simplified regulatory process that encourages the horizontal multi-stage fracturing needed to unlock both tight oil and a lot of unrecovered conventional oil.
- We would provide strong and continued support for systems to distribute and use carbon dioxide for enhanced oil recovery.



- We would consider applying drilling credits as an incentive for both tight oil and conventional oil investment.

Oil Sands

Over the long haul, done right, the oil sands are Alberta’s “legacy” ticket to many future decades of prosperity. But their development has become a source of controversy around the world.

Compared to many other oil-producing jurisdictions, Alberta has had helter-skelter development at a pace controlled by the market. Former Alberta premier Peter Lougheed has recommended a limit of one oil sands development at a time. Aggressive campaigns by some environmental groups are fueling a growing global public perception of the oil sands as “dirty oil”. How often do we read American and European critiques suggesting oil sands development constitutes a global environmental disaster or a climate change threat to the entire planet?

It doesn’t matter that it’s not true if enough people believe it’s true. Perception is reality, and if our customers believe we’re selling a bad product, they’ll buy from the competition. We need to meet this challenge with sound oil sands policy that promotes both sustainable activity and environmental protection, and does so in very obvious ways. To be effective over the long haul – environmentally, economically and socially – the development of the oil sands must be guided by vision and principles. The province can and must make the rules, set timelines and targets, and enforce compliance. Over time, rules need to be amended to reflect technological innovation and evolving conditions, but the current practice of constant changing and tinkering with them must stop. The rules must be clear and provide certainty for 50 year decisions.

- Contracts will be honoured for their duration, with the intention of reviewing and improving licenses at times of renewal.
- Conditions of license will be used to promote best practices and optimal development
- We would sit down with industry to remove the cap on royalties at the top end of oil prices (over \$120 a barrel).

Adding Value, Adding Markets

It is in Alberta’s best interests to be more than a supplier of raw material. Adding value keeps skilled jobs, money, and knowledge here at home. This is the principle behind the successful creation of Alberta’s petrochemical industry in the 1970s and 80s. But what strategy is most likely to work?

There has been a great deal of discussion about upgrading bitumen as a way of adding value. Some have talked about setting a goal – and creating the appropriate conditions and incentives to meet that target – that a significant percentage of the bitumen produced in Alberta is upgraded in Alberta.

Given the number of upgrading projects that have been postponed or cancelled and the significant environmental and water use impacts of upgrading, a better way to add value might be to encourage the expansion of Alberta's petrochemical industry. This would build on an existing strength, and create more of a market for natural gas as a feedstock.

Shipping exclusively south is not in the best interests of the citizens of Alberta or the industry. Having only one customer means the product will fetch a lower price than in a competitive market. It is in industry's interest, Alberta's interest and ultimately the national interest to open the Asian market to Alberta bitumen. It would seem to us to be a high priority to build an oil pipeline to the West Coast.

- We believe that adding value is important, and our target would be that current proportions of Alberta-based bitumen upgrading are at least maintained as oil sands development grows.
- We would undertake a detailed study of Alberta's petrochemical sector to identify capacity, potential for expansion, technology needs, capital availability, and market opportunities.
- We would work with British Columbia to prioritize the west-coast pipeline project, particularly the environmental approvals.
- We would make this project a point of particular emphasis at the federal level.



What if Alberta's Oil Sands Could Produce the Cleanest Oil in the World?

Continuous improvement is the only acceptable approach to developing the oil sands - pushing the envelope every day on innovations that will extract the oil with continuously reduced environmental impacts, smaller carbon footprints and lower costs. We want to engage people and businesses around the world in developing the technologies to accomplish this, and we would be willing to be their partner.

Companies are working on this on their own today – but it needs to happen faster, and in a more collaborative, coordinated way. The idea is to get producers, the province, and outside innovators working in partnership towards the goal of clean oil sands production without letting the usual proprietary interests get in the way.

Any breakthrough innovation would be available to all players at fair market value. The innovators would thus be compensated for their intellectual property but the exclusivity of use afforded by patent law would not apply.

- We see this as a ***Race-to-the-Moon***-scale quest to discover, develop, and apply the technologies that will unlock the oil from the sands in a carbon-free or carbon-reduced, environmentally-sustainable, earth-friendly way
- We would revive the Alberta Oil Sands Technology and Research Authority, a specific body that revolutionized oil sands development before, and will do so again.
- We would implement a 2 to 3 cent/bbl levy on bitumen production to fund the expansion of R & D spending
- Climate change is a reality and poses a significant challenge. We will act in good faith to reduce Alberta's carbon footprint.
- To achieve swift and significant action toward carbon efficiency, we would provide the option to partially offset emissions from energy use and development by paying into a technology fund.



Two Additional Points

First, this is a living document. The consultation process we used to create this document continues; it's an ongoing conversation with the oil and gas sector and the public, guided by the principles in this policy.

Second, in coming months, we will unveil additional policies on alternative and renewable energy, energy efficiency, electricity and environment. Together with this oil and gas policy, these proposals will fit together and work together to form a comprehensive Alberta Energy Plan.

We all want a cleaner, greener energy future and we all want Alberta to be at the leading edge of that future. A healthy oil and gas sector will help get us there sooner.



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