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A Risk Analysis of the Alberta NDP's Energy Policies: Death by a Thousand Cuts?

By Ted Morton, PhD

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About Ted Morton, PhD

Dr. Morton is currently a Senior Fellow, Energy and Environment, at the Manning Foundation and contributes to Manning Centre projects as well. He is a Senior Fellow at the School of Public Policy at the University of Calgary. In 2013, he was appointed by the Federal Minister of Industry to the Board of Governors of the Council of Canadian Academies.

He recently served as Minister of Energy for the Government of Alberta (2011-12). Prior to that, he was the Minister of Finance (2010) and Minister of Sustainable Resources Development (2006-2009). In 2001, he was the Director of Policy and Research for the Office of the Official Opposition in the Canadian House of Commons.

Dr. Morton is known for his expertise in the energy-environment interface in Alberta and federal-provincial relations.

Prior to his public service, Dr. Morton taught political science at the University of Calgary since 1981. His publications include five books and over 50 scholarly articles. Dr. Morton holds a B.A. degree (Phi Beta Kappa) from Colorado College and MA and Ph.D. degrees from the University of Toronto.

Executive Summary

Western Canadian oil and gas producers were already bleeding cash as a result of the collapse of oil and gas prices before Alberta's May 5 election. The surprise victory of Rachel Notley and the Alberta New Democratic Party (NDP) has compounded the industry's financial problems by introducing a new dimension of policy uncertainty. While the defeated Progressive Conservative Party was historically supportive of Alberta's oil and gas sector, the New Democrats have criticized the sector (and the PC governments) for royalties that are too low and environmental impacts that are too high. Alberta's new NDP premier, Rachel Notley, campaigned on the promise to reverse both.

This study identifies 13 specific policy risks posed by the new NDP government to the Alberta oil and gas sector. Each of these risks represents additional costs and/or loss of revenues. The study rates each of these risks for its potential severity discounted by its probability. While no one of these policies by itself poses a terminal risk, when taken together, if layered one on top of another, their cumulative impact may. The NDP's energy policies are still a work in progress. With the exception of the increases in corporate and personal income taxes and the CO penalties, the key decisions on the other policy risks are yet to come. It is still within the government's discretion to temper the impact of royalty increases, additional carbon levies and support for new export pipelines. Publicly Alberta energy executives are being cautiously optimistic and making re-assuring comments about their new premier and new government. But privately the fear is "death by a thousand cuts," and the mood is pessimistic. This study explains why.

A Risk Analysis of the Alberta NDP's Energy Policies: Death by a Thousand Cuts?

The surprise victory of the New Democratic Party (NDP) in Alberta's May 5 election has sent shock waves through the Canadian energy market. Led by Rachel Notley, Alberta's new premier, the NDP ended the 44-year dynasty of the Progressive Conservative Party (PC) by winning 54 of the 87 seats in the Alberta Legislative Assembly. The PCs were reduced to third-party status with only 10 MLAs, while the more conservative Wildrose Party won 21 seats to form the official opposition.[1] While the PC Party was historically supportive of Alberta's oil and gas sector, the NDP has criticized the sector (and the PC governments) for royalty regimes that are too low and environmental impacts that are too high. Notley's energetic election campaign promised to reverse both.

The resulting uncertainties around royalties, corporate taxes, CO2 emission policies and the prospects for new export pipelines have resulted in investor uncertainty and large capital outflows. The day after the NDP victory, the TSX dropped by over 150 points, driven mainly by investors bailing out of energy stocks. By the end of May, the S&P/TSX Energy Index had dropped 6.9% from 236.56 to 220.13. BNN investment guru Kevin O'Leary compared the NDP's victory to a "horror movie unfolding. … The end results of destructive NDP policies are well known; their party has left a trail of economic carnage across Canada. One can imagine the damage they could cause not only to Alberta's economy, but right across our great country."[2]

This analysis seeks to go beyond rhetoric by identifying 13 specific policy risks posed by the new NDP government to the Alberta oil and gas sector. Each of these risks represents either additional costs and/or loss of revenues to energy companies. Each is explained, and then rated for the potential severity of its impact and by the probability of it actually occurring. There are some risks that pose potentially extremely negative impact but whose probability is remote. Conversely, there are other risks that are all but certain to occur but whose impact will be negligible. These thirteen risks and their corresponding impact/probability scores are presented in Table 1.

Figure 1 provides a graphic representation of how many of these risks fall toward the red "dangerous" end of the risk spectrum (extreme impact, high probability) and how many fall closer to the green "safe" end of the spectrum (Negligible impact, remote probability). The yellow middle ground represents moderate risk and/or probability. Policy risks that are rated as having potentially high impact but are impossible to predict at this point in time are coded as "3" and "3." Visual inspection reveals that five of the thirteen risks fall squarely in the red zone, while the other eight locate in different zones of moderate risk. None fall in the green/safe zone. While this graphic confirms that the anticipated NDP policy initiatives pose material risks to Alberta's oil and gas industries, it may actually understate the problem. While none of these risks by itself is likely to threaten the economic viability of an energy company, when taken together, layered one on top of another, their cumulative financial impact risks "death by a thousand cuts."

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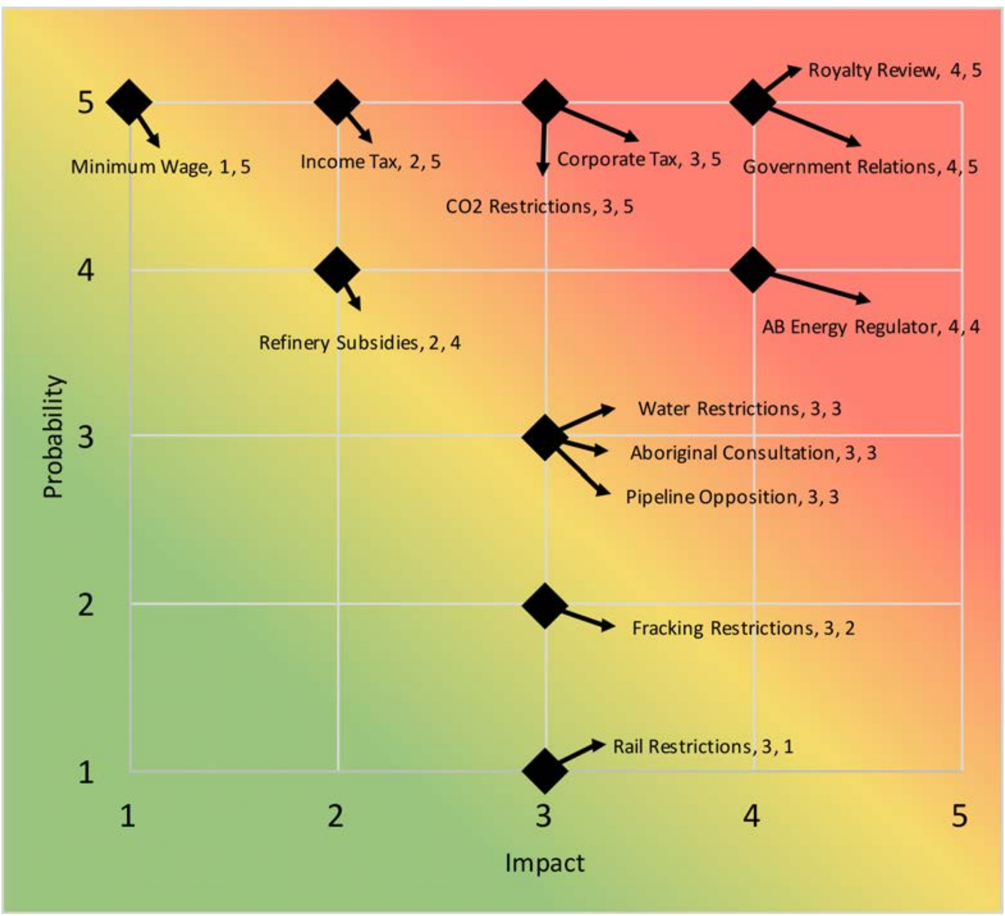
[1] The Liberal Party won one seat, as did the new Alberta Party. Following the election, the number of PC

[2] "Kevin O'Leary on NDP's stunning win in Alberta: 'It's a horror movie unfolding," Yadullah Hussain, Financial Post, May 7, 2015. http://business.financialpost.com/news/energy/oleary-on-alberta-its-a-horror-movie-unfolding

Table 1: Risk assessment of effects NDP policies on the oil and gas industry

Policy	Details	Impact	Probability	Impact:
Royalty Review	Risk of higher royalties	4	5	1 = Negligible
Corporate Tax	Increase from 10% to 12%	3	5	2 = Low
CO2 Restrictions	New restrictions on emissions	3	5	3 = Medium
Pipeline Opposition	Lack of support for new export pipelines	3	3	4 = High
Income Tax	Increase for higher income earners	2	5	5 = Extreme
Fracking Restrictions	New restrictions on fracking / unconventional	3	2	
Water Restrictions	New restrictions on water use / fracking	3	3	
Rail Restrictions	New restrictions on rail export of bitumen	3	1	**Probability:**
Refinery Subsidies	Subsidies for new refineries / upgraders	2	4	1 = Remote
Minimum Wage	Increase in minimum wage to $15/hour	1	5	2 = Unlikely
AB Energy Regulator	Abolish AER single-window regulatory review	4	4	3 = Moderate
Aboriginal Consultation	Expanded duty to consult & Aboriginal land claims	3	3	4 = Likely
Government Relations	Effective Industry communication with NDP Government	4	5	5 = Almost Certain

Figure 1: Risk assessment of effects NDP policies on the oil and gas industry



1. Royalty Review – Risk of Higher Royalties

This is a long-standing NDP policy commitment.[3] A royalty review was prominent in Notley's election campaign and affirmed in the Throne Speech. The prospect of a royalty review has spooked both the industry and investors, because of the still vivid memories of the negative impacts of the 2008 royalty review and "New Royalty Framework" (NRF) brought in by the Stelmach government. The NRF's higher royalties for both oil and natural gas led to an exodus of capital expenditures, a sharp decline in drilling and large job losses.

The NDP's royalty review will include a review of the various drilling incentive programs adopted in 2010 to encourage the drilling of new unconventional oil and gas wells that were then being tapped for the first time via directional drilling and hydraulic fracturing (see Appendix 1). The incentive programs have succeeded in increasing drilling for unconventional oil and gas in new resource plays such as the Duvernay, Montney and Cardium. But continued drilling assumes that all the incentive programs remain in place. In the new low oil price environment, these wells would not be drilled without the drilling incentives. Industry is lobbying hard to have these incentive programs renewed for at least another three years. There is also a request to extend a similar incentive program to deep oil opportunities that currently remain uneconomical and thus untapped.

There has been ambiguity around how soon this review will be completed. Industry would like to see it completed sooner rather than later. The uncertainty is not only spooking investors, but makes if difficult for companies to value their own assets. This problem was highlighted by an announcement by Murray Edwards, the high-profile CEO of Canadian Natural Resources, that CNRL would postpone its annual investor open house scheduled for June 17 because "detailed future capital allocation plans for each of the company's assets cannot be finalized at this time."[4]

Some of these concerns were removed by the June 26 announcement that Dave Mowat, CEO of Alberta Treasury Branch (ATB), will chair the royalty review panel. ATB has a significant energy-lending portfolio, and Mowat is viewed as fair and knowledgeable, someone who understands how the sector works. This was clearly not the case for the 2008 royalty review. Mowat has been tasked with choosing the other members of the committee—another positive sign—but the committee has not yet been given terms of reference and its report will be advisory only. No dates have been set for delivery of the committee's report, but the Energy Minister has said that it will be completed by the "end of the year." Suffice it to say that the sooner, the better for all parties concerned. The industry has also pressed the newly elected government to confirm that any changes to royalties won't be retroactive, but to date no such assurance has been given.

2. Increased Corporate Income Taxes (CIT)

During the election campaign, Notley promised to raise CIT from 10% to 12%. This commitment was quickly implemented in Bill 2. The CIT increase took effect July 1, 2015. While by itself this hike in CIT is unlikely to make or break energy companies, its cumulative effect (when combined with other cost increases and/or revenue losses) makes it a serious risk.

A tax increase that seems to have escaped much attention thus far is the increased rates for both eligible and non-eligible dividends. The tax on eligible dividends increases from 19.3% to 26.2%, an increase of ~ 36% for those in the top marginal tax bracket. The tax on non-eligible dividends increases from 29.4% to 35.7%, an increase of some 21%. Note that eligible dividends are paid for with after-tax

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[3] See Bill 209, "Resource Owners' Rights Commission."

[4] "Canadian Natural Resources Ltd postpones spending plans due to 'uncertainty' over Alberta NDP's energy policies," by Claudia Cattaneo, Financial Post, May 28, 2015.

dollars, so in effect a double tax. For Alberta residents/taxpayers, these increases decrease the attractiveness of those many Alberta energy companies that have moved to a dividend model.

Longer term it also means that Alberta no longer has the lowest provincial CIT. The new 12% levy will make Alberta the fourth highest in Canada and 17th highest of 44 OECD countries.[5] This will negatively affect Alberta's ability to attract capital and also corporate head-office re-locations—something Alberta has done well for the past two decades.[6] Note that the small business tax (for companies with less than $500,000 profits) will remain at 3%. This has little bearing on companies in Alberta's energy sector.

3. New Penalties on CO_2 Emissions

The NDP campaign promised "leadership" on climate change, a commitment that was repeated in the Throne Speech. This promise was delivered on June 25 when the new Minister of Environment Shannon Phillips announced that the current penalty on carbon emissions will be doubled to $30/tonne by 2017 and the intensity reduction targets will be increased from 12% to 20% over the same time period.[7] These changes are really just a more expensive version of the policy status quo, and were not unexpected. Alberta's existing policy on large industrial emitters was scheduled to expire at the end of June, and was generally viewed as ineffective—too narrow in scope, too complicated, and not incenting sufficient emission reductions. Even if Jim Prentice and the PCs had won the May 5 election, there probably would have been similar increases.

However Minister Phillips made it clear that these new rates are an "interim" not a final carbon policy, and announced the appointment of Andrew Leach, an energy economist from the University of Alberta, to head a new advisory panel on climate change policy. Dr. Leach has been tasked with delivering a "preliminary proposal" to the Minister prior to the planned climate change summit scheduled for this December in Paris—an event that the Premier has said that she will attend.

This announcement is double-edged. On the negative side, the implication that there will be still more carbon-reduction policies feeds industry and investor uncertainty. The positive side is the appointment of Dr. Leach as the head of the panel. Leach is respected as one of Canada's leading energy economists, and is consulted regularly by both industry and governments. It is difficult to imagine that he would make policy recommendations that were destructive of the industry or GOA energy revenues.

It is safe to assume that the panel's recommendations will initially focus on expediting retirement of coal-fired power plants—which until recently produced the majority of Alberta's CO2 emissions and are still responsible for 35%. A new natural gas fired cogeneration plant produces half the CO2 of a comparable coal-fired plant. The prospect for continued low gas prices now makes this an affordable alternative. The panel is also likely to recommend subsidizing consumer energy efficiencies and renewable energy, especially wind. The Government has announced that it will honour existing contracts to fund the two Carbon Capture and Storage (CCS) projects that they inherited from the prior PC governments, but are unlikely to initiate any new CCS, given their dire fiscal situation.[8] Note,

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[5] Ontario (11.5), British Columbia (11) and Quebec (11.9) will now be lower. See Jack Mintz, "Alberta's bad moves," National Post, June 18, 2015.

[6] Of TSX-listed companies, Alberta has 79 corporate head offices, second only to Ontario with 82. BC has 28 and Quebec 32. http://www.cbc.ca/news/business/oil-boom-sees-corporate-power-shift-to-alberta-1.2860839

[7] "NDP Doubles Carbon Tax," by James Wood, Calgary Herald, June 26, 2015, A1.

[8] The two CCS projects are Shell's Canada Quest Project (at its Scotford Refinery) and Enhance Energy's Alberta Carbon Trunk Line (connected to the Northwest Sturgeon Upgrader). The two projects are receiving GOA subsidies of $745 million and $555 million, respectively.

however, that the NDP government's support for new upgraders and refineries risk increasing Alberta's CO2 emissions. (See section 9)

The big question is what the NDP government will do about the oilsands—the single largest source of CO2 emissions in Alberta and the fastest growing source of CO2 emissions in Canada. Whether the NDP opts for some form of cap and trade or a more straightforward carbon tax, both would layer on additional costs. If you add these costs to anticipated increases in royalties and corporate tax rates, the twin issues of rate of return on investment and attracting capital become problematic. The Canadian Association of Petroleum Producers (CAPP) has stated that the announced increases in corporate income taxes and the hike in carbon penalties will cost the industry $800 million dollars over the next two years.[9]

Both the Premier and her Minister of Energy continue to repeat that by making Alberta "a leader in climate change" policy, they will win increased public acceptance of increased oil production and support for new export pipelines. Whether this assumption proves to be true remains to be seen.

4. Support for New Export Pipelines

Notley has been ambivalent on this issue. The Throne Speech referenced the importance of a "Canadian energy strategy," and the importance of getting Alberta oil and gas to new global markets in order to get global prices. But this is at odds with her earlier campaign statements in which she said she supports Kinder Morgan/Trans-Mountain and Energy East; but would not waste time on pipeline projects that aren't going to succeed anyhow—Northern Gateway and Keystone. Anti-oilsands groups immediately criticized the Throne Speech reference to the need for a Canadian energy strategy, pointing out that it contradicts her earlier statements. Notley may think that she can square this circle by making Alberta "a leader in climate change," and thereby appease the anti-pipeline lobby (See section 3), but this remains to be seen.

Notley's opposition to Keystone is also linked to her support for government incentives to build more upgraders in the province and to keep the valued-added and jobs in Alberta. While this is a non-starter from an economic/business perspective (See section 9), Notley is strongly committed to it. The pipeline risk is further complicated by Notlley's support for expanding Aboriginal land claims and the "duty to consult." (See section 12)

On balance, it is unlikely that Notley's government will do much if anything to help either Northern Gateway or Keystone XL. However she has publicly spoken in favour of Energy East, which with a million barrels/day capacity, is the largest of the four proposed pipelines. Notley is betting that her stronger commitment to CO2 reductions will translate into increased support for Energy East from the governments of Ontario and Quebec. Her lack of support for KXL is not critical. Keystone is a high priority for the Harper government, and it is the Federal government that speaks on this issue in Washington, D.C. Northern Gateway is different. It is difficult to imagine Northern Gateway being approved without a strong assist from the Alberta Premier's office. These concerns are amplified by the appointment of out-of-province, federal NDP operatives to key positions in the Notley government. (See section 13)

5. Increased Personal Income Taxes (PIT)

During the election campaign, Notley promised to raise PIT from 10% to 12% for individuals making more than $125,000/year and to 15% for those making over $300,000/year. These commitments were

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[9] "Big emitters welcome stricter rules," by Laruen Krugel. Calgary Herald, June 26, 2015, D1.

repeated in the Throne Speech, and put into law in Bill 2. However, because of missed deadlines with the Federal government (which collects provincial PIT for the provinces), these increases will not take effect until 2016. While unpopular with energy executives, their short-term impact on the industry should be minimal. Longer term, it means that Alberta no longer has the lowest PIT for high-income earners,[10] which will negatively affect Alberta's ability to attract high net-worth entrepreneurs (aka, "human capital"). The PIT increase will also make Alberta less competitive in attracting corporate head-office relocations.

6. New Restrictions on Hydraulic Fracturing/Unconventional

The kinds of hydraulic fracturing prohibitions adopted by some other provinces and US states will not happen in Alberta. Alberta has been recognized as a leader in the effective regulation of hydraulic fracturing.[11] Alberta was one of the first jurisdictions to require the disclosure of all chemical additives used in hydraulic fracturing. Its program for monitoring the environmental effects of hydraulic fracturing have been commended for their credibility, transparency and reliance on sound science. The Alberta Energy Regulator (AER) has been recognized as a "senior and respected regulatory agency" whose regulations with respect to hydraulic fracturing meet or exceed comparable regulations in the US. [12]To ensure wellbore integrity and protect groundwater, AER regulations prescribe the depth and quality of steel pipe and cement used to create the surface casing that encloses and insulates the top portion of the well bore.[13] The AER is also developing and piloting a "play-based approach" to well approvals—rather than the old well-by-well policy—to accommodate the larger regional scope and surface impacts of shale gas and oil development. The AER's "cumulative effects" approach aligns with and fulfills the regulatory operationalization of the regional plans being developed under the Alberta Land Stewardship Act, which divides the province into seven regions defined by its major watersheds. While Notley recently spoke of breaking up the AER's regulatory authority, even if this occurs, it is unlikely to change Alberta policy on hydraulic fracturing. (See section 7, for one exception)

7. New Restrictions on Water Use/Hydraulic Fracturing

Fresh water, both surface and ground water, is a scarce resource in Southern Alberta. There has been concern that the increase in hydraulic fracturing to extract oil and gas has had or could have an adverse effect on the quality and quantity of Alberta's fresh water resources. This has led to calls to prohibit the use of fresh water for hydraulic fracturing, as has been done in several other provinces and US states. However, the recent EPA report in the US should reduce concerns about adverse effects of hydraulic fracturing on ground water. [14] The study found that there is no evidence that the use of hydraulic fracturing has had an adverse effect on ground water in the United States.[15] An earlier Canadian study had similar findings.[16] While the new NDP government may undertake further studies and/or monitoring of ground water near wells that are being fracked, there seems little likelihood of any new regulations or restrictions.

There are two exceptions. Regardless of which parties form government in Alberta after the next election, expect new policy restrictions on the use of fresh water for hydraulic fracturing in Southern

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[10] Ontario, Newfoundland and Saskatchewan are lower, as are all three territories.
[11] The report of the Council of Canadian Academies, "Environmental Impacts of Shale Gas Extraction in Canada," (2014).
[12] Ibid.
[13] See Alberta Energy Regulator Directive 083 (Hydraulic Fracturing—Subsurface Integrity).
[14] http://www2.epa.gov/sites/production/files/2015-06/documents/hf_es_erd_jun2015.pdf
[15] "Fracking has not had big effect on water supply, E.P.A. says, while noting risks," New York Times, June 4, 2015.
[16] Council of Canadian Academies, "Environmental Impacts of Shale Gas Extraction in Canada," (2014).

and Central Alberta. Note that this would be a "policy" decision, and therefore outside the scope of the AER's regulatory authority. Depending on their severity, these restrictions could pose a hardship for industry.

The hydraulic fracturing industry is already developing methods of using re-cycled "flow-back" water from earlier wells to frack new ones. However, only 40%-60% of the water used can be recovered and recycled. Second, concerns about airborne pollutants from upgraders and tailing ponds contaminating surface waters in the Fort McMurray area persist, and are likely to be reviewed by the new NDP government.

8. New Restrictions on Rail Transportation of Bitumen

Increased transportation of oil by train has led to an increase in accidents with adverse environmental impacts (oil spills) and human deaths, such as the 2013 Lac Megantic tragedy in Quebec. This has led to calls for increased regulation and restrictions on oil by rail. Transportation of oil by railroad falls more under federal jurisdiction ("interprovincial and international trade and commerce") than provincial. Recently adopted regulations—applicable in both Canada and the US—requiring improved tanker construction/safety standards and reduced speeds in populated areas should suffice.[17] There is no indication that the Notley government will involve itself in this issue.

9. Government Subsidies for New Refineries/Upgraders

While this is a losing proposition for Alberta taxpayers, the "Refine it where you mine it" mantra remains popular and is a long-standing NDP policy commitment.[18] The Alberta Federation of Labour, a key member of the NDP's political base, supports it because it would further aggravate labour shortages, thereby driving up wages for its trade union members. This increase would contribute to higher construction costs for oilsands plants, which in turn would reduce GOA royalties from new bitumen production.[19] New refineries/upgraders would also risk increasing Alberta's CO_2 emissions, further complicating attempts to do the opposite. (See section 3)

The stark economic reality is that under current conditions it is impossible to build a profitable upgrader in Alberta.[20] The recently approved Northwest Sturgeon Upgrader is estimated to cost $8.5 billion dollars, and is still not completed or operating. A comparable refinery opened in North Dakota in May with a cost equivalency of $1.3 billion.[21] Using government subsidies just transfers the losses to Alberta taxpayers.[22] The North Dakota refinery is also fully dedicated to the production of diesel fuel, which is

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[17] "Canada, US to announce new rail safety standards for oil transport," The Globe and Mail, April 30,2015.
[18] See Bill 209.
[19] Oilsands royalties are based on a pre-payout, post-payout model to allow companies to recover their large initial capital costs. Pre-payout royalties top out at 9% of gross revenues, depending on price. Post-payout royalties run up to 40% on net revenues, depending on price.
[20] See "Why Alberta doesn't need any more upgraders," Oilsands Magazine, July, 2015. file:///Upgraders%20%7C%20Oil%20Sands%20Magazine_July2015.webarchive
[21] "Dakota Prairie oil refinery commences start-up operations," http://www.mdu.com/news/2015/05/04/dakota-prairie-refinery-commences-startup-operations . The refinery will process 20,000 barrels/day of Bakken light crude at an estimated construction cost of $430 million dollars. For equivalency of size (Northwest is supposed to process 50,000 barrels/day), I've tripled the cost of the North Dakota refinery to $1.29 billion for 60,000 barrels/day.
[22] See my two recent studies on Alberta's failed attempts at economic diversification ("The Siren Song of Economic Diversification: Alberta's Legacy of Loss," School of Public Policy Research Papers, volume 8, issue 13 (March, 2015); and "The North West Sturgeon Upgrader: Good Money after Bad?", School of Public Policy Communique, volume 7, issue 3 (April, 2015).

also one of the primary products of the new Alberta upgrader. As their target markets overlap, it's hard to see how on price the latter will be able to compete with the former. While it will be interesting to see how the NDP government handles this file, whatever they do will have minimal impact on conventional oil and gas.

10. Increase in Minimum Wage to $15/hour

This is an NDP campaign commitment, and it will happen. Alberta's current minimum wage is $12.20/hour. The first $1 an hour hike will take effect October 1, and the rest will be phased in over the next three years. While its effect on small business and the hospitality industry will be very negative, its impact on the energy sector will be minimal, as no one in the oilpatch works for minimum wage.

11. Splitting of Alberta Energy Regulator (AER)

Six weeks after the election, Premier Notley announced that she would order a review of the Alberta Energy Regulator because it has conflicting objectives—protecting the environment and promoting oil and gas development.[23] The AER was created in 2012 to provide cradle-to-grave regulation of oil-wells, oilsands, pipelines and coal mines. This regulatory mandate covers initial licensing through operations to reclamation and decommissioning.[24] The AER combines reviews that were previously conducted by three different regulatory agencies, each with a different mandate.[25] Industry complained of duplication and delay. The AER was intended to solve these problems with a "one-window" approach to regulatory review. At a minimum, to reverse the 2012 reform and return to the old regime would introduce new uncertainty and delays—at least in the transition stage. Many in industry see this as political interference with an independent regulatory authority for ideological reasons.

Notley's announcement was praised by environmental groups, which makes most industry players fear that breaking up the AER would result in a more time-consuming regulatory process. While it appears now that such a review will occur, its outcome is uncertain. But more regulatory uncertainty is just one more negative variable in terms of risk to the industry.

12. Expansion of Aboriginal Land Claims and Duty to Consult/Accommodate

While most other governments and energy companies were scratching their heads trying to figure out the policy implications of the Supreme Court's latest policy bombshell on Aboriginal rights,[26] Rachel Notley was campaigning to expand them. Section 5.21 of the NDP's campaign platform reads: "We will implement the 2007 United Nations Declaration on the Rights of Indigenous Peoples (UNDRIP), and build it into provincial law." Sections 26-29 of UNDRIP purport to grant even greater control over land and resource development than the Canadian court decisions discussed below. This almost certainly explains why the United States, Canada, Australia and New Zealand all voted against UNDRIP when the U.N. General Assembly adopted it in 2007.

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[23] "NDP eyes regulator split," Calgary Herald, June 23, 2015, A1.

[24] The AER's mandate is: "the safe, efficient, orderly and environmentally responsible development of hydrocarbon resources over their entire life-cycle. This includes allocating and conserving water resources, managing public lands and protecting the environment while providing economic benefits for all Albertans."

[25] The Energy Resource Conservation Board (ERCB); Alberta Environment (Environmental Protection and Enhancement Act and Water Act); and Sustainable Resources Development (Public Lands Act).

[26] "Confusion reigns on aboriginal rights when court rulings meet reality," by Jeffrey Simpson, The Globe and Mail, July 11, 2015. http://www.theglobeandmail.com/globe-debate/confusion-reigns-on-aboriginal-rights-when-court-rulings-meet-reality/article25413801/

As with other campaign promises, Notley is following through. On July 7, she sent a memo to all her Cabinet ministers instructing them "to conduct a review … of your Ministry's policies, programs and legislation that may require changes based on the principles of the [UNDRIP]." She set February 1, 2016 as the deadline for recommended actions.

This cannot be good news for the industry. Within Alberta, the judicially-created "duty to consult" with Aboriginals has exploded into a time-consuming and expensive process for E&P companies. If a well or pipeline is proposed on a site deemed to be on "traditional use" lands—which includes almost all of Alberta—then a company must hire "traditional knowledge experts" from the affected bands to determine and then mitigate or compensate for negative environmental or social impacts. Failure to fulfill this "duty to consult and accommodate" to the satisfaction of the affected band can result in litigation. Most companies would rather write a cheque than take the additional time and expense of going to court, and their aboriginal counterparts know it.

For the proposed export pipelines, this news may be worse. Whether to the West Coast or the East Coast, these projects cross dozens if not hundreds of reserves and "traditional use" lands. As one constitutional expert recently observed:[27]

> "It has become extremely difficult to get major infrastructure projects done in Canada. Amongst others, the impacts of aboriginal title and of the duty to consult on long linear infrastructure projects are subject to an immense lack of clarity."

In British Columbia, where (unlike Alberta) there are very few treaties, Aboriginal bands have successfully sued for "title" to Crown lands, with a corollary right to be consulted and accommodated for any development on such lands, even before these claims of title are resolved. The result: a small group of Aboriginal bands appear to have achieved a *de facto* veto power over Enbridge's Northern Gateway project, and other bands are trying to achieve the same with respect to Kinder Morgan's TransMountain expansion.[28] The consequences have been bluntly but accurately summarized by Dwight Newman:[29]

> "The possibility that projects might be cancelled based on set of unclear legal tests is not one that inspires investor confidence to put up the billions of dollars of capital Canada's resource sector needs in order to contribute to prosperity for all."

While these projects fall outside of Alberta's jurisdiction, it will be difficult for the new Alberta Premier to disregard aboriginal concerns about these export pipelines, given the commitments she has now made inside of Alberta. At this point, no one—including the Alberta government—knows where this file is going to land. It could end up being a public relations exercise with little practical effect. But it could also lead to increased expenses and/or lower prices for producers. Either way, it casts one more shadow of doubt across the future of the industry.

[27] Dwight Newman, "Is the Sky the Limit? Following the trajectory of Aboriginal legal rights in resource development" (June, 2015), p. 26. http://www.macdonaldlaurier.ca/files/pdf/MLIAboriginalResourcesNo7-06-15-WebReady-V3.pdf

[28] "Pipeline prospects take hit as Court grants land title to B.C. First Nation," by Dwight Newman, Financial Post, June 26, 2014.

[29] Newman, "Is the Sky the Limit?", p. 18

13. Industry Relations with NDP Government

Historically under prior PC governments, the Oil and Gas Sector has had direct and strong channels of communication to the Premier's Office and to key ministers. More often than not, these premiers and ministers were from Calgary and had personal friendships with various key players in the sector. Not by coincidence, companies and individuals in the energy sector were also active financial contributors to the Progressive Conservative Party and to the campaigns of key government ministers. This is over. There are no ministers or even MLAs with connections to the energy sector, and the NDP's first order of business (Bill 1) is to ban corporate and union donations to political parties.

Industry relations with the new NDP government risk being further weakened by the out of province NDP activists that are being appointed as chiefs of staff. The new NDP Cabinet has twelve ministers, including Notley. Ten of the twelve now have chiefs of staff who do not live in Alberta, several of whom have personal histories of being anti-oilsands, climate-change activists.

Notley has chosen Brian Topp to be her Chief of Staff, arguably the most powerful position in the Alberta government. Topp has deep roots in the federal NDP but is a newcomer to Alberta. He is on record with very negative comments about the oilsands and the Northern Gateway pipeline. Topp has also spoken in favour of a stronger carbon pricing policy, a hard cap on GHG emissions, and government support for building more refineries/upgraders in Canada, and against foreign ownership in Canada's oil industry.[30]

Equally concerning is the appointment of Graham Mitchell as chief of staff to Energy Minister Marg McCuaig-Boyd. Mitchell was recently the executive director of LeadNow, a firm that lobbies against proposed pipeline projects for Alberta's energy sector.[31] LeadNow's website refers to the oilsands as the "toxic tar sands" and says the National Energy Board's upcoming study of the proposed Energy East pipeline project is a "sham review process." By all accounts, Mitchell was solicited and appointed by Premier Notley's office, not by McCuaig-Boyd, who had trouble explaining to reporters how an anti-pipeline lobbyist could become Chief of Staff to Alberta's Minister of Energy.

Notley's use of out-of-province NDP operatives is also complicating communications and cooperation with the Harper Government in Ottawa and Premier Christy Clark's Liberal government in British Columbia. There is an understandable reluctance for Harper and Clark officials to share politically sensitive information with their new NDP counterparts in Alberta, if this information risks being used against them in future elections by other NDP parties. This lack of trust risks undermining the intergovernmental cooperation required to complete the proposed new export pipelines. (See section 4)

The Topp and Mitchell appointments (plus the other eight Chiefs of Staff recruited from outside of the Alberta) may represent the most serious risks to the industry. They will be tremendously influential. Chiefs of staff don't just give advice. They act as gatekeepers to their ministers. They filter the hundreds of letters, reports and requests for meetings that daily pour into each minister's office. Ministers read only materials and meet only with stakeholders and civil servants that have been cleared by their chiefs of staff. This risk of lack of trust and poor communications between the new NDP government and the energy sector will also influence how the 12 other identified risks will play out over the next four years.

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[30] "NDP's Brian Topp signals new directions for Alberta oilsands," National Observer, May 14, 2015.
[31] "The NDP energy chief of staff with the anti-pipeline past," The Globe and Mail, June 11, 2015.

Positive Scenario

Contrary to outward appearances, Alberta did not undergo a Jekyll and Hyde transformation from Tory blue to NDP orange on May 5. The government changed, and changed significantly. But the province did not. The majority of Albertans voted against the NDP (60%). The NDP received 40% of votes cast, but 61% of seats. Their majority in the new Legislature is a product of vote-splitting on the Right between the PCs and the Wildrose parties. Post-election surveying by Abacus Data indicates that the result was more about the desire for change (93% of respondents) rather than a preference for the NDP platform (7%) and that a large majority want the NDP government to support the province's oil industry, including the oil sands.[32]

The NDP victory was also driven by idiosyncratic issues unique to Alberta and unlikely to re-appear anytime soon—a new Premier who had never been elected and was in office less than six months; a "secret" merger of PC/WR parties in December; unhappiness with Premier Prentice's new "pay-more, receive-less" budget; an early election call that violated Tories' own fixed-election date statute; the desire for an effective opposition; voter fatigue with PCs after 44 years and five different leaders in last 9 years. It would be a real stretch to say that May 5 gave Premier Notley a mandate to transform Alberta.

There are other reasons to expect Notley to be pragmatic, not ideological, in her approach to energy policies. Unlike most of her caucus, she is not a rookie and has a grasp of the importance of foreign capital for oilsands development and the mobility of that capital. In her acceptance speech, she mentioned "competitiveness" twice and continues to do so.

Two of Notley's recent appointments also inspire greater confidence. With Dave Mowat heading up the royalty review (See section 1) and Andrew Leach leading the climate change panel (see section 3), industry has been re-assured that that these two key policy files will be handled in an informed, balanced and objective perspective at the policy development stage. Final decisions, of course, still rest with the Premier and Cabinet.

Notley also inherits all the same problems that just sunk Jim Prentice: low oil and gas prices; a $7 billion dollar shortfall in government revenues; growing unemployment; deficits and tax increases. If she wants to win the next election, she cannot have four years of record unemployment, deficits, debt and higher taxes. The only way the NDs can generously fund their favourite social programs (and public sector unions), and not either raise taxes or run huge deficits, is with increased oil and gas revenues. Getting Canadian oil and gas to new export markets and thereby eliminating their current price discounts would generate much more revenue for the Government than its corporate tax or royalty increases.[33] It will be in Premier Notley's own political self-interest to work with the energy sector, not against it. This was certainly the message she delivered at the Stampede Investment Forum in Calgary, where she described Alberta's oilsands as "a tremendous asset," and re-assured her audience that on her watch it would continue to be developed.[34]

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[32] "Alberta's election was more about change, less about the NDP, say voters," Bruce Anderson and David Coletto, May 17, 2015. http://abacusdata.ca/albertas-election-was-more-about-change-less-about-the-ndp-say-voters/

[33] See Adam Waterous, ""Don't worry about Alberta's NDP—worry about energy market access," The Globe and Mail, July 15, 2015.

[34] "Premier Notley sends a message to the energy sector." By Max Fawcett. Alberta Oil Magazine, July 8, 2015. http://www.albertaoilmagazine.com/2015/07/premier-notley-sends-a-message-to-the-energy-sector/

A recent IHS forecast confirms that oilsands production will continue to grow, albeit not as rapidly as it had previously projected. Notwithstanding lower prices and the new NDP policies, the fundamentals of oilsands growth remain strong: the third largest oil reserve in the world, proximity to the US market, and a stable political/legal regime.[35]

Negative Scenario

An alternative future may unfold if Notley concludes that her May 5 victory was an accident—the result of the convergence of a weird mix of issues (see above) that are unlikely to ever occur again. Under this scenario, she may not worry about re-election and pursue more ideological policies—including more aggressive increases in corporate income taxes, carbon taxes, and royalties. Under this "Damn the torpedoes, full speed ahead!" scenario, she may choose to try to build a legacy as the "Green Queen of the West," and hope that history will vindicate her somewhere down the road.

Notley may also be pushed in this direction by her young and ideological caucus. Forty-nine of the 53 members have no prior experience as MLAs. Indeed almost none have ever held any public office. Most are teachers, nurses, union organizers and even a few students. They volunteered to be NDP candidates not because they thought that they would be elected, but because of their ideological zeal—standing up for what they believed, which for many includes strong views on climate change, pipelines, oilsands and hydraulic fracturing. If Notley chooses to tack to the middle, one of her challenges will be to manage their expectations. Alternatively, if she chooses instead to try to build the "Green Queen" legacy, she will have a strong supporting cast.

Conclusion

Western Canadian oil and gas producers were already bleeding cash as a result of the collapse of oil and gas prices. (See Appendix #2) The surprise election victory of Rachel Notley and the Alberta New Democratic Party has compounded the industry's financial problems by introducing a new dimension of policy uncertainty. What is certain are increases in royalties, corporate income taxes, personal income taxes, and some form of new carbon levy. The only question is how much? The industry's cozy, 44-year relationship with Alberta PC premiers and key resource ministers is emphatically over. In its place are rookie ministers with no experience in or connections to the oil and gas sector. They are being advised and shepherded by chiefs of staff who are seasoned NDP operatives from other parts of Canada, several of whom are climate change activists with documented anti-oilsands and anti-pipeline pasts. Publicly Alberta energy executives are being cautiously optimistic and making re-assuring comments about their new premier and new government. But privately the fear is "death by a thousand cuts," and the mood is pessimistic. This risk analysis study explains their pessimism.

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[35] "Canadian oilsands to grow even in the lower oil price environment," http://blog.ihs.com/canadian-oil-sands-to-grow-even-in-the-lower-oil-price-environment?utm_campaign=PR_-018&utm_medium=press_release&utm_source=None

Appendix #1: Alberta Drilling Incentive Programs

Natural Gas Deep Drill Program: For gas wells deeper/longer than 2000 meters, per meter credits are allocated that can be applied against royalties owed. These credits are limited to the first five years., and their maximum per well value is capped at $10 million for exploration wells and $8 million for development wells. This program existed prior to 2010 and is scheduled to expire in November, 2016.

New Well Royalty Rate: Applies 5% royalty rate to all wells for first 12 months or 50,000 BOE, which ever comes first. This incentive can be combined with the Deep Drill credits. This is scheduled to expire in June, 2018.

Shale Gas New Well Royalty Rate: applies 5% royalty rate to shale gas wells for first 36 months, with no production cap. This incentive can be combined with the Deep Drill credits. This is scheduled to expire in June, 2018.

Horizontal Gas New Well Royalty Rate: applies 5% royalty rate to natural gas for first 18 months or 50,000 BOE, whichever comes first. This is scheduled to expire in June, 2018.

Horizontal Oil New Well Royalty Rate: applies 5% royalty rate to oil for first 18-48 months or 50,000-100,000 BOE, with the threshold increasing as the depth of the well increases. This is scheduled to expire in June, 2018.

These credit/royalty incentives create a temporary, front-end window that allows E&P companies to pay lower royalties (in the 5% range) in a well's early production years, rather than standard royalty rates that top out at 40% for oil and 36% for natural gas. These incentives provide time-value for the E&P companies by allowing companies to recover their capital costs in the early years of a well's production.

Appendix #2: Stress Indicators in the Alberta/Western Canadian Energy Sector

Indicator	2014	2015	% Change
West Texas Intermediate	$107	$50	-53%
Wells drilled in Alberta	5,960	3,100	-48%
Drilling jobs in Western Canada	49,950	25,110	-50%
Alberta land sales for drilling rights[36]	$231 million	$165 million	-29%
Oil & Gas Revenue (Canada wide)	$150 billion	$100 billion	-33%
Capital Expenditures-Oilsands	$33 billion	$23 billion	-30%
Capital Expenditure-Non-Oilsands	$23 billion	$12 billion	-48%

Note: Number of drilling rigs currently operating in Alberta: 91, or 12% of the fleet of 759 in Western Canada. For all of Western Canada (including Alberta), the figure is 147 out of 759, or 19%.

19 Oilsands Projects Cancelled or Deferred in 2015:

Joslyn
Foster Creek Phase H.
Sunrise 2A Expansion
Kirby North SAGD
Germain
Christina Lake Phase G
Kearl Expansion Phase 3
Teck Frontier Project
MacKay River 2
Lindbergh SAGD Phase II
Carmon Creek Phase3&4
Gemini SAGD Pilot Project
Carmon Phase 1 & 2
Corner Project
Narrows Lake
Pierre River Mine
BlackGold SAGD
Telephone Lake
Grand Rapids

ARC Financial reports that of the 33 major oil and gas projects delayed or cancelled in 2015, 16—or almost half—are in the Canadian oilsands.[37]

Junior Oilsands Companies in Creditor Protection/Receivership Since January

- Laracina
- Southern Pacific Resource Corporation
- Ivanhoe Energy

Note: Connacher Oil and Gas: restructured allowing creditors holding $1 billion worth of debt to take control of almost all its equity.

[36] These figures are for January-June and taken from Nickles. In 2011, a record year, the sales figure was $1.74 billion for the first 10 sales.
[37] "The Oil Business is a Tough Rodeo." Peter Tertzakian ARC Energy Charts, July 7, 2015.