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BUBBLING BITUMEN A BLACK EYE FOR OIL INDUSTRY

When it comes to describing the accident at the Canadian Natural Resources' oilsands operation near Cold Lake, "leak" doesn't do it justice. Neither does "spill."

A "leak" can be plugged. A "spill" implies a one-time event.

What's happening at CNRL's project is neither. For the last three months, 7,300 barrels of bitumen have uncontrollably bubbled to the surface from deep underground and seeped into muskeg and water on four sites at the company's operations, creating an ecological mess, killing wildlife and damaging the reputation of CNRL in particular and the oilsands industry in general.

The company has cut down trees, hauled away tons of oily muskeg and put containment booms on a contaminated lake. But the bitumen keeps coming, seeping out of the ground through long, narrow fissures. Not only has CNRL been unable to stop it, the company doesn't know for sure why it keeps coming.

The Pembina Institute based in Calgary disturbingly describes the leak as an "uncontrolled blowout in an oil reservoir deep underground."

On the surface, though, it is not a "geyser" as some environmental groups have dramatically described the flow. It'd be more accurate to say the ground is suppurating bitumen, or maybe festering. Or, if you insist on being dramatic, weeping.

But those descriptors don't do justice to the size of the surface contamination. Enough bitumen has oozed out of the ground to half fill an Olympic swimming pool. Put another way, in volume, it's about one-third the size of the Enbridge accident that dumped more than 20,000 barrels of oil into Michigan's Kalamazoo River in 2010, causing the largest inland pipeline spill in United States history and creating an $800-million cleanup job.

No matter the size or how you describe it, an oil spill is not a pretty sight, not that it's been easy to take a peek at the CNRL accident. The affected area is not only remote, it is on the Cold Lake Air Weapons range, which means it is out of bounds to civilians. Its inaccessibility has made the story all the more intriguing to journalists, not only in Canada but around the world.

On Thursday, company and military officials took a gaggle of local, national and international reporters to the site to see for themselves. My colleague, Sheila Pratt, was among them and reported that 200 workers are urgently trying to clean up the mess and prevent migrating birds from landing on a small lake in the contaminated area: "In an effort to scare off birds, noise cannons are booming, flags flutter on the site, decoys of predators dot the lake and bizarre mannequins peek out of trees," wrote Pratt.

The problem seems to be related to the company's in situ process for recovering bitumen. In what's called "high-pressure cyclic steam stimulation," CNRL injects steam into deep wells to melt the bitumen. After weeks of injection, the process is reversed and bitumen pumped to the surface. CNRL officials think the leak was caused by an old well bore that couldn't withstand the massive underground pressure and they say the problem should improve as the underground pressure decreases.

However, the province's governmental watchdog, the Alberta Energy Regulator, says it's too early to reach any conclusions about the cause, and the regulator has ordered the company to stop steaming in the affected area. There remains the possibility the problem was the result of a crack in the overlying cap rock created by the high-pressure steaming process. That would be a much larger problem for CNRL. It's one thing for the company to plug up an old cracked well bore, but quite another to deal with cracks in a geological formation.

It would also be a much larger problem for the oilsands industry that is moving away from open pit mining to in situ methods designed to be less environmentally disruptive. The CNRL incident is raising troubling questions and providing ammunition for environmental groups to once again attack the industry.

Also troubling is the fact this is the second CNRL leak in the same area. In 2009, 5,600 barrels seeped into the environment. A cause was never conclusively reached, but the provincial regulator said "geological weakness, in combination with stress induced by high pressure steam injection" may have contributed to the incident.

Greenpeace spokesman Mike Hudema says regulators need to review the in situ methods: "How do we identify what formations are safe to take high-pressure steam?"

Given that the industry plans to recover 80 per cent of the oilsands through the in situ process, CNRL and regulators must come up with some answers. The first and most obvious is what happened at the operations near Cold Lake?

It doesn't matter if you call it a leak or a spill or an underground blowout — we need to know what caused it and what it means to the integrity of the oilsands industry.

CANADA MUST ACT QUICKLY ON ITS RESOURCE BOUNTY, SAYS NATURAL RESOURCES MINISTER JOE OLIVER

Calling the development and export of Canada's resources "nation building," federal Natural Resources Minister Joe Oliver says Canada must seize a once-in-a-lifetime energy opportunity or watch the associated economic benefits disappear.

As the minister trumpets the need to develop Canadian resources, he hopes the U.S. government will make a decision on the Keystone XL pipeline as quickly as possible and downplayed a story in the New York Times that suggested — contrary to a U.S. State Department report — the pipeline could significantly increase oilsands production.

Extracting Canada's natural resources demands that governments do more to earn the social licence to develop the oil, gas, diamond, uranium and other lucrative deposits found across the country, Oliver said Monday at the annual meeting of Canada's energy and mines ministers in Yellowknife, N.W.T.

Yet, groups observing the talks, such as Environmental Defence, say the feeling around the conference is "very disconnected with the reality" of Canadians' concerns about the impacts of natural resource development on land, water and air.

In a keynote speech to fellow ministers, Oliver compared the development and export of the country's natural resources to the building of the railroad across Canada or construction of the St. Lawrence Seaway.

Canada must capitalize on its resource bounty while it still can, he said.

Doing so requires the federal, provincial and territorial governments to develop Canada's abundant natural resources, build the needed infrastructure — such as pipelines and export terminals — and diversify the country's markets beyond the United States to emerging economies, he said.

Failing to act could see the country pass up billions of dollars in economic benefits and thousands of jobs, he said. The moribund Mackenzie Valley natural gas project, which faced a regulatory review of nearly a decade, was an "irretrievable loss" for a generation of aboriginals in the Northwest Territories, he said.

"So we have a choice — to proceed or procrastinate. We can roll up our sleeves or wring our hands. We can decide to get this done or we can dither — and watch the opportunities pass to others," Oliver told his counterparts.

"Because make no mistake, this moment — this opportunity — is perishable. It will not last forever."

Oliver downplayed the New York Times report that highlighted Natural Resources Canada documents from early this year suggesting that approving the Keystone XL pipeline would increase oilsands production.

A U.S. State Department report released in March found that approving or rejecting the project is unlikely to have any substantial impact on the rate of oilsands development.

"Whether it's built or it isn't built, there wouldn't be a net impact on global emissions," Oliver told reporters, believing Canadian crude would simply displace Venezuela oil in the U.S. if Keystone XL was built.

With news reports out of the U.S. suggesting the Obama administration's final decision on Keystone XL could get pushed back to 2014, Oliver said the federal government respects the American process and that Canada hopes "the decision will be made as expeditiously as possible."

Gillian McEachern with Environmental Defence said a larger discussion is required in Canada about what's necessary in a national energy strategy that helps transition to a low-carbon energy system over the next couple of decades.

Part of the discussion needs to be about the pace and scale of development of the oilsands and shale gas, she said.

Ministers must also acknowledge, she said, that a discussion about Canada's energy strategy for the future is also its climate strategy.

"The decisions that people in these rooms will make over the next five years are going to determine whether Canada is on a path to transition to low carbon and build the industries of the future and tackle climate change … or lock us into a really high carbon future, which is dangerous," she said in an interview from Yellowknife.

Oliver said that while governments in Canada have an obligation to benefit from the natural resources, they also must honour their commitment to the environment — which he maintains is "our first thought in every major project we undertake."

However, the "once-in-a-lifetime opportunity" to secure prosperity and economic security can only be achieved if accomplished safely for Canadians and the environment, he added.

He highlighted Enbridge's proposed Line 9 pipeline reversal and TransCanada's Energy East project to ship crude oil from Western Canada to refineries in Quebec and Atlantic Canada as examples of important initiatives that will help expand the country's energy export markets, along with Keystone XL and liquefied natural gas projects in British Columbia.

Oliver said he has no problem with Canadians who have legitimate concerns about environmental safety and are open to a discussion based on science. But the minister said he objects to people and groups who oppose "virtually every form of resource development."

"Canada was not built by naysayers," he said.

Kevin Lynch, vice-chair of BMO Financial Group and former clerk of the Privy Council, told ministers it's imperative that Canada diversify its trade and investment.

The strongest economic growth in the world is coming from emerging markets that Canada must target for exporting its resources, he said. However, Canada continues to send most of its exports to traditional trading partners that are in the slow-growth part of the world.

"We've got a mismatch," Lynch said. "We're in the slow lane."

He noted Canada sends virtually all of its oil and natural gas to the United States, at a time when the U.S. is becoming increasingly energy self-sufficient due to development of shale oil and gas.

At the same time, 97 per cent of new global energy demand is coming from emerging markets that Canada has largely failed to tap to date, he said.

"We have a single buyer and that single buyer is an increasingly unreliable buyer of our energy exports, and that's a difficult place for us to be in," Lynch added.

BULLISH ON CANADA: OIL FIELDS SERVICES STOCKS AND HEAVY OIL PRODUCERS

Interview with fund manager Chris Theal and Keith Schaefer editor/publisher of OGIB...

The Big Investing Themes for Kootenay Capital fund manager Chris Theal right now is oil field service companies (OFS), and heavy oil producers.

Driving these two themes are:

1. Liquid Natural Gas (LNG) in North America

2. The huge growth in moving heavy oil by rail

"The reason to be overweight services is that we are seeing a change in the face of the oil field service consumer in Canada," he told me in a recent phone interview from his Calgary office.

"The customer base is increasingly geared to national oil companies, the super majors—it's no longer a junior just adding a rig or two when commodity prices go up. And you run down that list and you have Petronas going from five-to-25 rigs in the Montney play. I think, Chevron and Apache are gearing up for a very active 2014 in the Horn River-Liard Basin and Petrochina in the Duvernay."

We packed a lot into our 40 minute talk. We talked about which sectors he thinks will go up (Oil Field Services and heavy oil producers), where he's ambivalent (natural gas and yield securities—interest rates are going up) and what he thinks might be a good short soon (US refiners). We also talked about The Big Mistakes retail investors make.

But he was most keen on what the opportunities are for capital gains in the Canadian Oil Fields Services sector due to all the spending to get ready for LNG exports off Canada's west coast.

"A couple of heavyweights, Chevron and Apache, are looking for specialized rigs to be built and put into the field up in the Liard and Horn River Basins for very LNG oriented type activity.

"That is creating demand for specialized rigs and pumping gear. I say specialized rigs because if you look at the rig count we're about 100 rigs lower year-over-year and you really have to dissect the data to see the underlying strength in rigs that can drill deep, horizontal wells.

Theal says that year-over-year, well licenses are up close to 70% for the deeper 5,000 meter wells. So it's important to have exposure to the drillers that have the Tier 1, high horse power rigs that specialize in deep drilling.

"For us that's stocks like Western Energy Services (WRG-TSX) and Trinidad Drilling (TDG-TSX). But for every Tier 1 rig that goes to work there is a multiplier effect of well completions—and whether it's outright pressure pumping or coil tubing we think there is a far bigger impact on the pumpers." (Ed.Note- 'pumpers' is industry lingo for the hydraulic fracturing companies).

"So we own Canyon (FRC-TSX), we own CalFrac (CFW-TSX) and we own Essential (ESN-TSX) on the coil tubing front. That sub sector has been one of the top performing sectors within the energy space this year. We've had really good performance out of it and it remains number one with very good momentum.

"So the fundamentals are there and I think as we come out of June it will be a seasonal period of strength in that space. So far it has been strong and it's been more the pumpers. I think the Tier 1 drillers are the next that will really see that move."

Theal's second Big Theme in 2013 is heavy oil—which has turned around very quickly, due to rail transport. Only six months ago in December 2012 Canadian heavy oil was trading under $50 a barrel on some days, because of pipeline constraints and refinery shutdowns. Now it's just a few pennies shy of $80/barrel—and Theal says that pricing is here to stay.

"The big change is you have rail impacting the market. Canada's moving about 80,000 barrels a day of 'heavy' right now and we think that will double by the end of the year. And combined with the coker conversion at BP's Whiting, Indiana refinery we actually think new demand (infrastructure) will outpace any new oil sands supply coming on.

"In the last week we've seen a couple of investment houses turn bullish – narrowing heavy oil differential assumptions meaning higher realizations for the producers. I think we're going to see more of that.

"The bottom line is from a heavy perspective we're seeing new demand infrastructure related capacity coming outweighing new supply and that's going to keep differentials narrow and I think momentum on heavy oil prices favours the producers, so that would be the number two long allocation in the fund."

Theal believes the Canadian oil price has even a bit more upside left, and the stocks of Canadian heavy oil producers should benefit:

"With rail, pay the transport cost to get it to the US Gulf Coast where Mayan heavy is trading at $100 a barrel, so 100 less 20 to get it there you're seeing the potential for $80 realizations."

But the Keystone pipeline is still a big issue for Canada, Theal adds.

"I think as much as rail is physically changing market access right now,the international investor sits and looks at Canada and says 'Well you know what, I see reasonable value there but there is this Keystone debate'. The whole market access issue in Canada has been galvanized around that pipeline.

"I think it's a very big headline event to the Canadian sector. We think Keystone is going to be approved; it's just a question of when. When it is I think it is 'Risk On' for international investors coming back into Canada. I would say you'll see senior heavy oil stocks up 10% the day Keystone gets approved."

Now, by definition, high Canadian heavy oil prices are bad news for US refiners—that's their input costs. Besides that, the Brent oil price upon which their refined products are sold has stayed flat so Theal is avoiding that sector.

The other sector to avoid energy infrastructure dividend stocks. That sounds counter-intuitive, but Theal says they are going through acorrectionnow and he's playing that on the short side.

"I think the number one negative theme is with the 10 year yields rising and all the interest sensitive sectors, whether they're REITs or energy infrastructure—they are really rolling over and rolling over hard.

"As the 10 year yield goes up analysts will start increasing their discount rate. I'd say it's more acorrectionthan a secular call in that space. And when discount rates go up you kind of let the air out of the tires a little on that sector and that's what is happening right now. It's way more pronounced in the US than Canada at this point.

"And I think right now yield sensitive securities generally are seeing out flows.

Theal on natural gas: "We're pretty balanced on our gas view. I don't want to say we're short gas because we're not, but we've a more tempered view of the upside from here in gas and generally our high conviction picks have lots of resource optionality that we don't have to pay for. And our shorts are exactly the opposite of that; where the market is fully pricing in the upside. We just don't think the environment is one where we pay for a bunch of undrilled inventory, particularly when so many companies are trying to sell themselves."

Theal is now on the buy-side, as a fund manager, but also spent 13 years on the sell-side, as an brokerage firm analyst. With that kind of experience, what does he think retail investors could do better in their research, to make money more consistently in the energy markets?

First thing, he says, is find management teams who know how to manage debt; their balance sheet.

"I think if you go back through my length of time, the guys that ran really good companies and were successful through any part of the cycle–they had balance sheet discipline. It was generally the first slide in their presentation.

"They would consistently find a nice deal to do—but they would back stop it with equity and shore up the balance sheet and retain a lot of financial flexibility.

"Now you see guys out there doing deals with debt on the hope that they can show the market an accretive acquisition, get a bump in the stock and then do a subsequent financing. The market, I think, is more efficient when it sees stuff like that particularly in the small cap environment that we're in.

The other suggestion he gave me is a bit more difficult for retail investors. He says most oil and gas plays are a lot more variable than you might think. Management will say what the "type curve" is for their play—how much oil they produce over what time frame. But investors should understand that's generally a bullish number.

Then what happens is the sell-side analysts use simple math, extrapolating out thattype curveto every well over the entire acreage in the Company's play, and put a juicyNPV, or Net Present Value on it.

Geology and economics rarely work together that way.

"What you want to see in good work is—what is the variability around thattype curve. Then you should assign a higher risk factor and a lower chance of success."

Of course, investors could put some of their portfolio into the hands of specialist fund managers ;-).

"I think an important thing of being a specialist fund in a sector is (1) getting the commodity call right and (2) getting the sub sector call right. It's really understanding capital flows within energy and how they move around from sub sector to sub sector. So really moving into services we've been there early and that's worked well and I think we're just at the front end of the heavy oil thesis."

OIL SPILL WOULD 'OVERWHELM' RESOURCES, B.C. MINISTER WARNED

Oil industry dominates working groups and advisory committee, says NDP

Officials in British Columbia privately warned the environment minister that the province lacks the ability to manage oil spills from existing and future oil traffic, and even a moderate spill would overwhelm their ability to respond, documents show.

Ottawa's decision to deal with coastal oil spills from a base in Quebec would make it much harder to contain spills, and Transport Canada and the Coast Guard lack the needed "environmental expertise" to manage them, said the documents obtained by The Canadian Press under freedom of information laws.

The notes written by B.C. Environment Ministry bureaucrats for the incoming Minister Mary Polak in June, voiced a range of misgivings about the province's ability to respond to an oil spill. Other concerns were detailed by emergency response officials in memos last year.

"The Ministry of Environment, as the ministry responsible for preparedness, prevention, response and recovery for spills, is not adequately staffed and resourced to meet the existing and emerging expectations to address spills," they wrote in the briefing book.

"Even a moderately-sized spill would overwhelm the province's ability to respond and could result in a significant liability for government . . . The industry requirements, established by Transport Canada, are perceived as being insufficient in both scope and scale. For example, in both Washington State and Alaska industry requirements are far in excess of what is required in B.C."

The B.C. government has said Enbridge's proposed Northern Gateway pipeline — which would deliver Alberta oilsands products to a tanker port in Kitimat, B.C., for export to Asian markets — and Kinder Morgan's proposed expansion of its existing TransMountain pipeline into the Port of Metro Vancouver, could increase tanker traffic by more than 1,000 trips annually off the Pacific coast.

Enbridge is seeking approval for its project from the National Energy Board's joint review panel, which finished its hearings in June and is expected to make a recommendation on whether the pipeline can go ahead by the end of the year.

For the TransMountain project, Kinder Morgan has yet to formally submit its proposal for its required federal environmental review.

Risks outlined in briefing

The briefing notes many risks of a spill from a tanker negotiating B.C.'s coastal waters.

"Weather conditions and the remoteness of the pipeline's route in B.C. could cause cleanup delays, leading to broader water, land and wildlife contamination. Sensitive habitats, local economies (fisheries and tourism, for example) and First Nations along the route could be affected."

The briefing book estimates that at a rate of 500,000 barrels of crude oil a day, a pipeline spill lasting an hour could lead to 21,000 barrels spilling into B.C.'s wilderness.

When spills occur, under Canada's polluter-pay principle, the polluter must start the response and pay for damages and clean-up costs.

The lead government agencies — the Coast Guard for water spills and the National Energy Board for land spills — don't physically manage the incident itself but guide the polluter's actions.

Environment Canada's task is to be always on call to provide scientific-based expert advice.

The B.C. environment ministry has several mandates such as overseeing provincially regulated species and all B.C. Crown lands, and it has final authority over the final disposal of waste materials from a spill.

Mark Johnson, a spokesman for Environment Canada, said in an interview Ottawa agreed last March to create a tanker safety expert panel, due to report this November, and to fund eight new steps to ensure a "world-class" tanker safety system for shipping oil and chemicals "before major new energy infrastructure becomes operational."

These steps include more tanker inspections and monitoring, research, and the creation of a Canadian Coast Guard incident command system.

But last year, B.C. emergency response officials wrote that money was not the only problem: "Coast Guard and Transport Canada are to receive increased funding to respond," stated one memo. "However, these agencies do not have the required environmental expertise."

As well, cuts in the 2012 federal budget prompted Environment Canada to close its regional spill response offices in Vancouver and other cities and consolidated these in Quebec.

In May 2012, documents show officials in the B.C. Environmental Emergency Program in Victoria privately wrote this relocation would hinder efforts to contain an oil spill on the west coast. Those warnings were written about then-existing oil traffic, without factoring in future pipelines and tankers.

Program manager Graham Knox wrote in an internal memo: "As a result, Environment Canada will have little or no surge capacity in the event of a major spill to bring in responders from across the country."

"Trying to provide the current level of service from Montreal is not realistic. Current EC staff have found it challenging to respond to spills outside of their base in Vancouver, and a move to Montreal will certainly increase these challenges many-fold."

The document show local program officers agreed: "Not a good day," wrote one. "Looks like heavier dependence on the province. Response activities cannot be managed remotely. Preparation and accumulation of local knowledge are vital to a cohesive and coordinated response to emergencies."

Johnson declined to comment on the concerns outlined by Knox.

Addition workload for B.C.

Stuart Bertrand, a spokesman for the B.C. environment ministry, confirmed in an interview the province now has "some additional workload" due to the relocation "and the reduced capacity of EC emergencies staff that now work out of Quebec."

Bertrand added that the B.C. government is now exploring the concept of a new provincially-regulated but industry-led and funded "terrestrial spill response cooperative," and "while we are pleased with the steps Ottawa is taking, we are also pressing forward with our own review to help define our world-class marine spill system."

Federally, the shipping industry is responsible for funding the Western Canada Marine Response Corp., which responds to about 20 marine spills a year at a cost of about $5.3 million.

But Polak's briefing book indicates a concern about the lack of commercial vessels that could be used to help in the event of an oil spill: "The level of (industry) resources, including spill response assets and trained personnel, provided to the Canadian Coast Guard for spill response appears to be inadequate and may be even more challenged with the anticipated increase in large vessel traffic on the B.C. coast."

Johnson pledged new federal research on marine pollution risks and how to reduce oil-spill effects on marine life and habitats.

In February, Transport Canada, working with the Coast Guard and Environment Canada, sought proposals for a Canadian-wide risk assessment study on ship-source oil spills, and awarded the contract to Genivar Inc.

Yet last year, Knox regretted the loss of at least one existing resource, notably Ottawa's firing of the internationally respected Canadian oil spill expert Kenneth Lee and the elimination of his research centre in Dartmouth, N.S.

"This will limit resource managers' access to critical scientific expertise when making response decisions in the future," he wrote. "Oil spill expertise is eroding."

Oil interests dominate working groups

The NDP's environment critic is also raising concerns that the working groups set up to improve oil spill response in B.C. are stacked with people from the oil industry. Environment Minister Mary Polak created the three working groups and one advisory committee this spring, but Vancouver-West End MLA Spencer Chandra Herbert says 80 per cent of the members of the advisory committee and nearly everyone on the three working groups represent the oil industry.

"With the exception of First Nations representation, their advisory groups are almost entirely composed of people promoting the industry they are meant to be regulating," he said. "Where are the citizens? Where are the environmental groups that are dedicated to protecting our coast? And how are we going to get a good solution when we have such a one-sided panel focused on the oil industry?"

Chandra Herbert says he's concerned the industry-weighted groups could favour lower standards instead of best practices, and says he would like to see scientists, academics, tourism and environmental groups included as well.