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WHO'S AFRAID OF \$50 OIL? (ANSWER: CANADA'S OIL INDUSTRY)

Oil below \$50 a barrel could spur another leg down for Canada's oil industry

It may be high summer on the calendar, but Canada's energy companies are already looking towards the coming winter.

What they see is looking worse now than it was even a month ago.

After a rough start to the year that saw companies lay off thousands of workers amid falling crude prices, lower cash flow and wounded share prices, a spring rally in oil was stirring hopes the dreaded other shoe might not drop.

A July-long slide took oil prices back below \$50 a barrel, so a rally is looking less likely.

"It's a very difficult time in our industry, one of the most difficult in decades," said Tim McMillan, chief executive of the Canadian Association of Petroleum Producers, the lobby group for the energy industry. "The mantra that I've heard pretty consistently from companies



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is preparing for lower for longer." Whether the earlier rounds of staffing cuts and budget reductions are preparation enough to weather what's expected to be a dismal winter drilling season is a question that is already starting to be answered.

In the next few weeks, Canada's oil companies will get down to the

serious work of crafting next year's budgets. Those plans will come together in September on the way to getting approved in November.

For Canada's oil sector, the winter drilling season, which begins when the ground freezes enough for heavy equipment to move through the northern parts of the country, is where the rubber

will hit the road for the industry. Western Canada's oil business follows a predictable quarterly pattern; busy in the first three months of the year, which is where companies make a lot of their money. Quiet for the next three during spring breakup, when rigs are taken down and moved through the muskeg before the seasonal warmth thaws the ground.

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Ending with a ramp-up of production through the second half of the year which launches companies back into the peak busyness of winter.

This year that blueprint is being disrupted.

A lack of mid-year activity is to be expected given the drop in oil prices, but what's more concerning at this point is the shape of things to come.

By now, drilling companies and other oilfield services providers should typically be having conversations with exploration companies about the needs of the upcoming season. Uncertainty about commodity prices is making this year different.

"Either they're holding their cards tight to their chest and not letting anyone know what their plans are or they don't know themselves at this point," said Duncan Au, chief executive of

CWC Energy Services. "Even now at \$50 [oil] we are seeing maybe those plans that were in place are now starting to be put off or put on hold."

The nature of the oil industry means drillers are the first to get hit when a downturn comes and the first to come back when the cycle turns for the better.

Compared to last year at this time, the number of active drilling rigs in Western Canada is down by half. Against this backdrop, many drilling companies have already cut staffing levels by a third.

"Companies are going to have to make some hard decisions and they already have," said Jackie Forrest, a vice-president at ARC Financial, an energy focused private equity firm. "I think we'll be seeing more of those as the year unfolds."

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Whether the reductions to date will be enough or if more are needed will depend on several factors including commodity prices and the willingness of the market to keep investing in the sector through equity or debt issues.

So far this year, the external market has stepped up and allowed explorers to bridge the drop in cash flow from lower commodity prices and activity levels. If that continues, the industry may well be able to muddle through a tough period without suffering through any deeper cuts.

If not, more layoffs and some reluctant mergers upon threat of bankruptcy — particularly for the drilling sector — could be on the way.

At this point, however, the situation, while worrisome, is not yet that dire.

It's in the interest of banks, for one, to see the notoriously cyclical drilling

industry make it through this current downturn as intact as possible, even if it means renegotiating breached debt covenants.

"It's not terrible, but it's moving towards a concerning level and that's going to make banks take a hard look at these companies in the fall and figure out what needs to be done," said Dana Benner, an oilfield services analyst at AltaCorp Capital. "At the end of the day, banks don't want to own the assets, not these assets and certainly not those of bigger companies, they tend to want to work with them. That's been the history."

In the months to come, the industry will need understanding lenders and the continued belief of the market. But what would really help is a bounce back in commodity prices.



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Preparing for lower for longer when oil is at \$60 a barrel takes on a different complexion than when it's below \$50. Heading into the fall when key decisions will be made about budgets and staffing, the industry may now be changing its assessment of how low and how long.

**ALBERTA MAY SEEK
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BAD IMAGE**

Alberta's new government is engaged in a balancing act. It's trying to cut carbon emissions while protecting

an oil-sands industry that supports hundreds of thousands of jobs.

Tar sands are found almost exclusively in the western Canadian province. They produce a product that generates about 17 percent more carbon dioxide on average than conventional oil, and emissions in Alberta have risen by more than 53 percent since 1990.

At the same time, oil is the nation's single most valuable export, making up nearly a fifth of total foreign sales.

The challenge for the government is to work with an industry, already struggling with price cuts, on

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ways to hold off environmental criticism of the tar sands.

Opponents have so far blocked the Keystone XL pipeline that would carry the oil to the United States and limited the world's third-largest reserve from reaching new buyers.

"If Alberta wants better access to world markets, then we're going to need to do our part to address one of the world's biggest problems, which is climate change," Shannon Phillips, who was appointed Alberta's environment minister in May, said at a news conference June 25. "Nobody knows this better than the people

who work in our energy industry."

Alberta in 2007 introduced a carbon levy of C\$15 (\$12) per ton of CO2 for large emitters not meeting government-mandated reductions.

A price on carbon would have to ramp up to at least C\$100 a ton by 2030 to incentivize emissions cuts, said Matt Horne, associate regional director at the Pembina Institute, an environmental research group, in a July 6 phone interview from Vancouver, B.C.

"With fossil-fuel users taxed for their consumption, as well as industry, Alberta's overall

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emissions would stand a better chance of declining," said Horne.

"The province emits the most carbon from coal-power plants in the country," he said.

Obstacles to cutting emissions while preserving the industry are high.

"It's very hard to see a credible climate policy that would allow continued expansion of the tar sands," said Anthony Swift, an international lawyer at the Natural Resources Defense Council, a New York-based environmental lobbying group.

"The key point is to not focus on the tool, but think about the objective: actual emissions reductions," Swift said.

The Alberta government plans to increase the levy next year and again in 2017 as a temporary measure before a new climate policy is introduced. It hasn't indicated how much of an emissions cut it is targeting.

Some producers, including Suncor Energy Chief Executive Officer Steve Williams and Freehold Royalties CEO Thomas Mullane, are leaning toward establishment of an economy wide carbon tax that would be designed to make emissions expensive.

The revenue would allow governments to lower income and other taxes.

The producers want to avoid restrictions on oil expansion.

The benefits of a tax include the predictability of price increases and its easy application to all consumers, according to Horne.

Other options include a cap-and-trade regime that would impose limits

on CO2 output, while possibly linking Alberta with Quebec and California's markets for the climate-warming gas.

We need "to address emissions from all sectors, not just the petroleum industry," Phillips, the environment minister, said during the June news conference.

"If we get it right, our environmental policy will make us world leaders on this issue instead of giving us a black eye around the world."

In neighboring British Columbia, fossil-fuel consumers pay a C\$30 per ton tax of carbon emitted, which corresponds to 6.67 cents a liter for gasoline (20 U.S. cents per gallon). Per capita use of fossil fuels has declined 16 percent since it came into force in 2008.

Sweden has among the highest carbon tax in the world at about \$150 a ton for some emissions, making it cheaper for generators to switch to biomass.

The jobs of Premier Rachel Notley and Phillips are made harder by the plunge in oil prices and the fact that Alberta's oil sands, which have helped make Canada the world's fifth-largest crude producer, are already among the most expensive producers.

Canada's economy shrank 0.1 percent in April after a 0.6 drop in the first quarter, according to Statistics Canada.

The country exported C\$81.7 billion of oil derived from bitumen in 2013, the most recent full-year figure available.

"It's important that all Albertans are in this project together and it's

very unhealthy to point fingers" at one kind of emitter such as the oil-sands industry, Chris Ragan, a McGill University economics professor and head of Canada's Ecofiscal Commission, said in a phone interview July 6.

His group seeks to boost economic activity while reducing the environmental impact. "Everybody is an emitter," Ragan said.

KEYSTONE XL PIPELINE BILL: ALBERTA WILL NOT LOBBY U.S.

Provincial energy minister says Alberta will focus energies on other pipelines

Amid talk U.S. President Obama is about to reject the Keystone XL pipeline, Alberta Energy Minister Marg McCuaig-Boyd says the provincial government will not intervene.

"It's in their hands," McCuaig-Boyd said in an interview.

North Dakota Republican Senator John Hoeven said this week that Obama will reject the proposed pipeline, and that the announcement will be made in August, after Congress adjourns for its summer break.

That comment was given additional heft Wednesday when White House deputy press secretary Eric Schultz said that a decision on Keystone would come during this administration.

The proposed pipeline would move bitumen from Alberta's oilsands to refineries in Texas. It has faced intense environmental opposition, both over concerns about leaks from the

pipeline and about how much oilsands pipelines add to global greenhouse gas emissions.

Hoeven said Obama would reject Keystone on environmental grounds.

During the Alberta election campaign, now-Premier Rachel Notley said she would not make trips to the United States to lobby for Keystone XL. That policy continues to hold now that the NDP is in government

"We're going with the ones that are probably going to have the most success soonest," McCuaig-Boyd said. "Energy East has some promise and so does Kinder Morgan's Trans Mountain. Those are the two right now to put our energies into."

McCuaig-Boyd said that Keystone XL is too caught up in U.S. politics to intervene.

"I think with the election coming and a few others things; it's in their hands more than ours."

"I think if he [Obama] says anything, he'll say no," said Christopher Sands, a fellow with the Hudson Institute think-tank in Washington, D.C.

Sands agree with McCuaig-Boyd that Keystone XL is politically tricky.

Democratic presidential candidate Hillary Clinton dodged a question in a town hall on Tuesday, refusing to answer whether she would sign a bill allowing the pipeline.

"The White House might be thinking that if the president simply rejects it now, then Hillary Clinton can say, 'Well, I always said it was up to the president, he made this decision, the company can



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always file again," said Sands. "That allows her to kick this off her plate." Despite lower energy prices, market access remains top of mind for Alberta's energy sector. Production in the oilsands is still increasing and shipping oil by rail is more expensive than shipping it via pipeline. As oil prices have slid, so have shipments of oil by rail. In the first quarter of 2015, exports of oil by rail were at their lowest level in two years.

TransCanada spokesman James Miller said in an interview that the pipeline is still needed.

"Our trigger for building a pipeline, such as Keystone, is we need to sign long-term binding contracts with those companies" who want to ship oil to Gulf Coast refineries.

"One thing we've been consistently able to do in the midst of all the controversy over the last seven years is to maintain 100 per cent shipper support," he said.

However, while energy companies continue to support Keystone XL, they are also finding other ways to get oil to those Texas refineries. Both TransCanada and its competitor Enbridge have been working on end-runs around Keystone, projects such as Enbridge's Seaway Pipeline and TransCanada's Marketlink.

Those efforts appear to be working. The amount of crude exported from Canada to the Gulf Coast nearly doubled between the time of April 2014 to April 2015, according to data from the U.S. Energy Information Administration.

Prime Minister Stephen Harper said in an interview with Bloomberg that the delays in approving Keystone XL are not a hopeful sign.

That lack of hope is probably appropriate, Sands said.

"I think probably, with the base fired up, Obama thinks it's better to disappoint the Canadians and the business community and please the environmentalists, who are much more vocal."

B.C.'S LNG JOB CLAIMS DISPUTED IN NEW REPORT

Canadian Centre for Policy Alternatives calls its report a reality check

A new report from the Canadian Centre for Policy Alternatives refutes the B.C. government's claim that the Pacific Northwest LNG project will create 100,000 jobs.

"We find this to be a manufactured statistic," lead author Marc Lee said.

Lee says the LNG project's costs outweigh its benefits. He cites greenhouse gas emissions and the impact on the water supply in exchange for what he says are small gains in jobs and revenue. Lee calls the report a reality check.

"The potential gains have been vastly overstated by the provincial government while in a sense, they are privatizing a public resource," Lee said.

Lee points to job numbers from Petronas, the company behind Pacific Northwest LNG. He says

once the facility is built, only 2,000 to 3,000 jobs will remain.

Lee says that's a long way from the 100,000 jobs the B.C. Liberals have promised even if all five planned facilities are eventually built and there is no way of knowing how many of those jobs will be temporary or filled by foreign workers.

But Rich Coleman, B.C.'s Minister of Natural Gas Development, says many of the 100,000 jobs will be spinoff jobs — in other words, work the LNG industry will create indirectly.

"If you add jobs up and down the chain, there are service jobs that have to be done. There are spinoff jobs that

come from that. It affects everything," said Coleman, citing everything from housing construction to new Tim Hortons restaurants. "You can't put \$36 billion into an economy and not have significant spinoffs," he said.

He also said the CCPA report did not consider the 2,000 to 4,000 pipeline jobs that will be created by the project itself.

Coleman says the CCPA did not consult the LNG industry in its report and points out the government is citing numbers from credible accounting firms, Ernst and Young, and KPMG.



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