The Oilpatch Packs its Bags

Financial Post
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November 6th 2018

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Encana's announcement last week that it was acquiring Texas-based Newfield Exploration may be good news for the Calgary-based company, but it is not good news for Canada. It is the most recent chapter in an unfolding story of capital flight from the Canadian energy sector. First the big internationals, and now Canadian-based firms like Encana, are moving their operations and/or capital budgets out of Canada and relocating their money to the U.S. and elsewhere. And it's no mystery why. Thanks to government policies adopted by the governments of Prime Minister Justin Trudeau and Alberta premier Rachel Notley since their respective elections in 2015, Canada has become a less and less competitive place to invest and do business.

EnCana's $7.7-billion deal for Newfield's oil assets is its most recent U.S. acquisition. Encana had already made significant new investments in the U.S. in the Permian and Eagle Ford fields over the past three years. This spring Encana CEO Doug Suttles moved to the company's Denver office, sparking fears that Encana's head office — with its 1,000 employees in Calgary — may soon move with him. Encana insists that this will not happen. We'll see. Half its board of directors are now U.S.-based, and with the Newfield acquisition, 60 per cent of Encana's production is now in the U.S.

Encana is only the latest example of the exodus of capital since 2015. Initially it was primarily large international companies. In 2016–17, seven international energy companies, including Statoil (Norway), Total (France), Shell (Netherlands-U.K.), Conoco Phillips (U.S.) and Marathon (U.S.), dumped all or most of their Western Canadian assets — over $37 billion in sales.

More recently, it has been Canadian energy companies shifting their focus and their capital to the tax-and-regulation friendlier U.S. Encana has led the way, but the list of followers is growing. Enerplus has made significant investments in the Bakken and the Marcellus plays, and most recently in the Denver basin. Crescent Point is now spending more on its Uintah and Bakken properties than in Canada, and Baytex is doing the same in the Eagle Ford in Texas.

Predictably, Canadian energy-service companies are following the money to the U.S. If Calgary-based Precision Drilling succeeds with its proposed takeover of Trinidad Drilling, it will have more rigs in the U.S. than in Canada. That has the oilpatch wondering whether Precision's CEO might also be consider moving himself to Houston. This past January, Calgary's Akita Drilling explained the benefits of its $209-million merger with U.S.-focused Xtreme Drilling as providing "immediate scale in the U.S. market, building upon (Akita's) recent strategic expansion into the Permian." Last year, Total Energy Services acquired Savanna Energy Services to give it more exposure to U.S. and Australian markets. Other Calgary-based service companies that are expanding their U.S. investments include Calfrac, Ensign Energy, Ideal and Phoenix.

After being burned by their respective pipeline proposals for Northern Gateway and Energy East, Enbridge and TransCanada have also headed south with major new acquisitions. In 2016, Enbridge paid US$28 billion to buy Houston-based Spectra Energy Corp. This acquisition makes Enbridge the owner of the largest network of oil and natural gas pipelines in the United States.

The same year, TransCanada paid US$10.2 billion to acquire Houston-based Columbia Pipeline Group. TransCanada is also seeking trademarks on new company names that would excise the word "Canada" from its name. It has sought trademarks on the names TC Energy, TCE, Ventiv, Convergent and Northbow, sparking concerns that it too may be considering moving its head office to Texas.

Even Canadian pension plans have begun investing in U.S. energy assets. In 2017, the Canada Pension Plan Investment Board announced that it would invest up to $1 billion to buy oil and gas assets in the United States in a partnership with Encino Energy Ltd. The Ontario Teachers' Pension Plan is using its own subsidiary, Heritage Royalty, to acquire significant holdings in the Marcellus field in Pennsylvania.

So when will this exodus of capital stop? It won't, until policy-makers in Edmonton and Ottawa realize the costly consequences of their post-2015 policies and correct them.

Canada's export pipeline fiascos — first Northern Gateway, then Energy East and now Trans Mountain — are the direct cause of the current, record-breaking fifty-dollar discount on Canadian oil shipped to the U.S. Until a new export pipeline to a coastal port is built and operating, neither American nor Canadian companies will have much interest in investing in new Canadian production.

First and foremost, this means that the Trans Mountain expansion to Vancouver — and new Asian markets — must be completed. When will that be? No time soon, and certainly not before the next federal election. The Liberal government's passive response to this summer's court decision halting Trans Mountain's expansion is purely political. It is designed not to alienate the climate-change voters who helped the Liberals win swing ridings in B.C. and Ontario in 2015.

Beyond that, the prospects are not much brighter. Does Bill C-69, the Liberals' proposed Impact Assessment Act meant to replace the current project-review regime, address the causes that derailed Northern Gateway, Energy East and Trans Mountain? There is an overwhelming consensus that it does not. It expands the number and kinds of policy requirements that must be satisfied, such as upstream and downstream emissions. It does nothing to clarify or formalize what concrete steps must be taken to satisfy the judicially created test of Aboriginal consultation. And it opens the door to even more advocacy group interveners, whose goal is not better, safer pipelines but no pipelines. As currently written, Bill C-69 does nothing to improve the predictability, certainty and timeliness that any future investors would require.

But getting new pipelines built will not by itself solve Canada's competitiveness issues. The renewal of NAFTA — the U.S.-Mexico-Canada Agreement — is widely and rightly seen as positive for Canada. But these benefits come with certain costs.

With freer trade, the U.S. has become not just our largest export market, but also our primary competitor for capital investment. As border restrictions thin, U.S. companies can invest in Canada, but Canadian companies can also choose to invest in the U.S. And capital goes where it gets the best return.

This means that Canadian governments — both federal and provincial — no longer have the kind of policy freedom that they once enjoyed. Changes with respect to corporate taxes, personal income taxes and capital-depreciation allowances all have consequences for our larger economy. The same is true of a whole host of regulatory policies, from environmental to labour, that impose time-consuming obligations, and thus new costs, on Canadian businesses.

Since 2015 both the federal and Alberta governments have raised corporate and personal income taxes and phased out favourable tax deductions. The negative impact of these changes on our competitiveness has been aggravated by the reduction of similar taxes in the U.S. under a Republican president.

But the real kicker has been the climate change policies adopted by both Ottawa and Alberta since 2015. These include not just the carbon tax, but also new methane emissions regulations, the 100-megatonne hard cap on oilsands emissions and the phasing out of coal-fired electricity and its replacement by more expensive wind and other renewables. The cumulative effect of these policies makes it more expensive to do business in Canada, especially for "energy intensive, trade-exposed" companies (EITE).

Not surprisingly, Canadian oil and gas is the highest EITE sector in Canada. It takes a lot of energy to produce oil and gas and therefore more CO2 emissions. About 78 per cent of what we produce is exported, and 99 per cent of these exports are sold to the U.S. at prices set by international markets. This means that carbon taxes and other climate-change-related costs cannot be passed on to American purchasers. They are taken out of Canadian producers' bottom lines. This explains the growing exodus of Canadian capital and energy companies to the U.S.

The unpleasant but inescapable fact is this: Canadian carbon-reduction policies must be more or less in line with what the Americans are doing. If we impose higher carbon penalties than the Americans do, investment capital will simply go south. This is what economists call "carbon leakage." It not only scares away capital investment and jobs to lower-cost jurisdictions but also achieves no net reduction in carbon emissions. The emissions just follow the money and enter the atmosphere from the other side of the border. It's a lose-lose option, and it's where we are right now.

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