April 5, 2001

Mr. Dick Cheney
Vice President
United States of America

Dear Vice President Cheney,

Re: Oil and Natural Gas Strategies for North American Energy Markets

We are pleased that a review of North American energy matters has been initiated and welcome the opportunity to provide you and your National Energy Policy Development Task Force with our views. The Canadian Association of Petroleum Producers (CAPP) represents over 150 oil and natural gas producers or about 95% of the oil and natural gas production in Canada.

Oil and natural gas trade between Canada and the US works well within the existing framework. Overall, market forces are prevailing and driving the appropriate decisions. Both producers and consumers of oil and natural gas are receiving competitive prices that are leading to effective responses. We support continued reliance on market forces.

Canada’s oil and natural gas resources are an important part of the global crude oil and continental natural gas markets. In order to continue the development of these supplies to meet the growing need for energy by consumers in Canada, the United States and Mexico, a renewed policy effort is needed to enhance the current market-based policies that already exist.

These strategies must support both responsible resource development and the infrastructure to deliver those resources. They should:

- build on and enhance the successes in energy trade;
- recognize resource development in North America as a policy priority and reform regulatory practices to facilitate responsible, market-driven resource activity;
- ensure competitive tax and royalty regimes for the energy industry; and
- ensure consistent environmental policies and strategies among the various jurisdictions and agencies with the goal of maintaining the current high standards of protection.
Again, we appreciate the opportunity to provide this input on matters of such importance to North America. We would be pleased to discuss these strategies with you and your task force colleagues.

Sincerely,

Raymond I. Woods,
Shell Canada Limited
Chairman, CAPP

William A. Friley, Jr.
Triumph Energy Corporation
Past Chairman, CAPP

Attachment

copy: US Energy Secretary Abraham
A Submission by the
Canadian Association of
Petroleum Producers
About CAPP...
CAPP represents 150 companies whose activities focus on exploration, development and production of natural gas, natural gas liquids, crude oil, synthetic crude oil, bitumen and elemental sulphur throughout Canada. CAPP member companies produce approximately 95 per cent of Canada's natural gas and crude oil. CAPP has 120 associate members who provide the broad range of services that complete the infrastructure of this country's upstream crude oil and natural gas industry.

CAPP's Mission
To enhance the economic well-being and sustainability of the Canadian upstream petroleum industry in a socially, environmentally and technically responsible and safe manner.
Executive Summary

Canada's oil and natural gas resources are an important part of the global crude oil and continental natural gas markets. In order to continue the development of these supplies to meet the growing need for energy by consumers in Canada, the United States and Mexico, a renewed policy effort is needed to enhance the current market-based policies that are already working well.

Renewed energy strategies are needed:

- to support development of the oil and natural gas resources of North America, and
- to support the development of the additional infrastructure needed to bring oil and natural gas supplies to market.

Support means strategy and policy that are consistent with the operation of free markets and open competition, and provide the frameworks that facilitate responsible, environmentally sound development.

Key Strategies

Build on the success of free trade to increase non-discriminatory treatment of energy investment and trade in energy commodities.

- Build on and enhance the successes in energy trade in the North American Free Trade Agreement and the Canada/United States Free Trade Agreement.
- Continue market-oriented policies that respect and support freedom of contract and contract sanctity.

Recognize resource development in North America as a policy priority and reform regulatory practices to facilitate responsible, market-driven resource activity.

- Ensure coordinated and timely action for the development of frontier natural gas within a framework of inter-jurisdictional co-operation, recognizing the market will decide timing, routing, size and other aspects of development.
Ensure tax and royalty regimes are competitive compared to other jurisdictions or industries and also reflect the actual risk, cost or natural decline profile of the activity.

- Ensure tax competitiveness to encourage development of domestic resources.
- Tailor tax and royalty regimes to the risk and cost profile of the resource activity and to the decline profile of the resource.

Ensure consistent environmental policies and strategies among the various jurisdictions and agencies with the goal of maintaining the current high standards of protection and enforcement.

- Encourage joint and coordinated research and development in areas which facilitate beneficial technological change including energy efficiency, environmental sustainability, and enhanced resource recoveries (coal bed methane, carbon dioxide sequestration, enhanced oil recovery).
- Streamline the regulatory processes for the responsible development of new supplies.
- Encourage energy efficiency and conservation through policy and public education initiatives.

As we move forward in developing more global strategies to address energy production and consumption, it is critical that we do so in a manner that recognizes the continental and global nature of energy supply and the increasing interdependence of our economies.
Introduction

The fundamental strategic objective: a policy framework that supports and facilitates free trade and open competition.

As we enter the 21st century it can be said, as never before, that North Americans share a common market, have common problems, and must work together to seek common solutions. The issues and the solutions now cut across all energy commodities as a result of increased energy interdependence and electricity deregulation. For example, increasing the supply of natural gas contributes to solving the lack of electricity generating capacity. The solutions will involve every level of government. Some solutions will involve national, domestic actions; some solutions will involve international, North American actions. The fundamental goal, as always, is to achieve an overall framework of government policy that supports and facilitates free trade and efficient, competitive markets.

The main focus of this paper is on the supply of oil and natural gas to North American markets. Canada has established itself as a secure and reliable energy trading partner. The Canada/United States Free Trade Agreement and the North American Free Trade Agreement provide a firm foundation for the further evolution of free, non-discriminatory energy trade and beneficial competition. The market is working but governments can do more to support responsible market-driven resource activity.

Section A

Let’s do more of what works

The market works — free trade and competition are good

It is important to remember that policies supporting free trade and competition in energy emerged from the failures of interventionist, command-control government policies. We know the consequences of policies, however well intentioned, that restrain and prevent markets from operating freely and competitively. The cost to society is huge and far outweighs any perceived short-term benefit.

What did the protectionist policies of the 1960s and 1970s with their market restrictions and price controls achieve? United States crude oil production went into decline. Canada went from being a net exporter of crude oil to being a net importer in the space of a decade. Natural gas supply shortages emerged in both the United States and Canada in the early 1970s. Natural gas markets shrank. Supply shrank as well. The supply shortfall persisted. Forecasters expected the supply shortfall to continue for the long-term even as real energy prices were forecast to steadily
increase. Consumers faced the worst of all worlds: increasing prices and declining supplies. In reality, energy prices have been well below those forecast in the era of regulated markets and controlled prices.

What have free trade and competition in crude oil and natural gas achieved? Natural gas markets have grown rapidly. Production in both the United States and Canada has increased significantly. United States natural gas producers have captured about 60% of the market growth compared to 40% for Canadian producers. Canada’s oil production, which responds to global market forces, has also increased by 50%.

The huge potential of Canada’s oil sands has been unlocked. Canada’s East Coast frontier regions have been opened as a result of the market forces and entrepreneurial spirit. These have been reinforced by public policy and fiscal regimes that recognized the front-end risk.

In the mid-1980s, no one would have predicted the magnitude of the impact of technological change on exploration and production, the productivity gains that new technology would yield, or the cost-savings resulting from streamlined operations.

Dramatic improvements in drilling technology have reduced the time to drill wells. Horizontal drilling has become a standard industry tool enhancing the productivity of individual pools and reducing the number of drilling platforms and pads. New seismic technologies have increased success rates and led to new successes in older areas. New technologies have significantly reduced costs of oil sands development. Energy used and emissions per unit of production are dropping. Technology is also reducing the industry’s environmental “footprint” both on land and offshore.

We have all been impressed by the gains in productivity. But should we be surprised? Once again, the world as it emerged has proved the truth of our fundamental principles. Competition fosters diversity of thought and approach, rewards risk-taking, encourages the adoption of innovations, is outward-looking, thrives on change, and drives continuous improvement.
Competition has benefited consumers

Competition has done what people expect: prices came down. In contrast to the price escalations forecast in the era of regulated markets and controlled prices, lower prices have been the reality. A lower world oil price has been the reality of the past 15 years. The price of delivered natural gas in the United States declined substantially in real terms following deregulation and even in nominal terms have been flat or declining. In Canada, natural gas well-head prices declined in nominal terms and even more in real terms in the years following deregulation. Only now are natural gas prices in Canada approaching $2.00 levels in real terms. Natural gas prices are set competitively in a continental supply and demand dynamic.

![Canadian Natural Gas Price, 1980 - 2000](image1)

![North American Natural Gas Price Comparison](image2)

Source: CAPP Statistical Handbook and
canadian Natural Gas Price (prices NYMEX and Alberta)
Source: CAPP Natural Gas Report

Obtained and made public by the Natural Resources Defense Council, May 2002
In the ten short years following 1985, the productivity of the upstream oil and gas industry doubled as measured in oil and gas production per employee. It is clear that competition has extracted much of the value of productivity from producers to the benefit of consumers. Producers are price takers in North American energy markets.

Over time, market forces will yield prices that support the cost of maintaining and increasing supply

Energy prices that are too high for too long are not good for producers or consumers. Markets are lost. Economic growth is reduced. Ultimately, there is reduced, supply-oriented activity and a smaller number of competitors.

Similarly, energy prices that are too low for too long are not good for producers or consumers. Interest in energy conservation is reduced. Supply is not maintained. People and expertise needed to find and produce the supply are lost. Markets become complacent about energy security. Over time, it is the price signals transmitted through a functioning competitive marketplace that will balance supply and demand. Over time, the competitive price for supply will be paid.

Free markets require that buyers and sellers be able to decide the contractual arrangements that suit them

Deregulation of oil and natural gas markets was founded on the principle of freedom of contract. The freedom of the willing buyer and the willing seller is fundamental to the operation of a market. Buyers and sellers are free to structure contracts in any way they choose: long-term and short-term supply or purchase commitment; long-term or short-term price commitment; pricing driven off an index; etc. At any given time, there will be numerous supply and pricing arrangements in place in the market. This is an enormous strength of the oil and natural gas market that should be fostered and cherished.

Free trade and open competition also rest on the sanctity of commercial arrangements. Respect and support for the choices of buyers and sellers are basic to market-oriented policies and are the essence of "let the market decide".

Buyers and sellers must be able to access each other freely

The Canada-U.S. Free Trade Agreement and the North American Free Trade Agreement enshrine free market access for Canadian and U.S. oil and natural gas. They stand as monuments to farsighted government policy and international diplomacy. It is time to build on this foundation to expand opportunities for investment and to further reduce the potential for disruptive and unnecessary trade investigations of energy commodities. Energy investment and commodities should receive full, non-discriminatory national treatment. For example, exclusion of Canada from the U.S. Department of Commerce section 232 reviews of oil imports would be appropriate.
Section B
North America is resource rich — let's develop the energy

Higher current energy prices are a signal to the market

Energy demand, driven by extraordinary economic growth in North America, has grown at a faster pace than the growth of supply. The slowing of economic growth may cool energy demand and higher energy prices will also spur conservation. However, the clear signal is that more supply is needed.

The current higher price signal is spurring the supply response

Drilling for oil and natural gas responds very quickly to changes in market signals. Current high prices have quickly taken rig utilization to record levels. Drilling is also at record levels. In 1992, with low prices, 920 natural gas wells were drilled in Canada. This year, almost 10,000 natural gas wells will be drilled.

The focus of activity also responds quickly to changes in market signals. Lower natural gas prices lead to greater emphasis on development drilling, particularly in shallower or better known areas. The result is smaller pools with lower productivity. The current higher prices are driving greater explanatory activity and a shift in focus to deeper targets and to less-well-known areas. This is seen in the shift in activity in the Western Canadian basin to the higher cost, higher risk areas in western and northwestern Alberta, northeast British Columbia, and the southern Northwest Territories and Yukon. Equally dramatic is the interest and activity in the East Coast offshore areas and the Mackenzie Delta. These all result in larger pools with higher productivity.

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Investment in oil and gas exploration and production in Canada - excluding the massive investment in oil sands noted below - climbed past C$15 billion in 2000 and is expected to approach C$20 billion in 2001.

**Oil sands and Atlantic Canada will provide growing, competitive sources of supply**

North American energy demand has spurred the technological innovation and cost efficiencies that are unlocking the potential of Canada's oil sands. Of the total 2.5 trillion barrels of reserves in place, an estimated 300 billion barrels are recoverable with current technology. This scenario rivals Saudi Arabia's proven conventional reserves of about 265 billion barrels.

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**The market is working: oil and gas supply is responding.**

Canada's oil sands are a significant and accessible strategic resource.
To develop this resource, massive investments are required. In the order of C$3 to C$5 billion per year have been invested since 1996. Investments in excess of C$40 billion have been announced for the current decade ending 2010. The positive investment climate must continue to be favourable or these new opportunities will be lost.

Canada’s Atlantic offshore oil resources are being developed and have significant potential for further development. Hibernia is producing 150,000 barrels of oil per day and subsequent projects such as Terra Nova (production to commence in 2002). White Rose, Hebron and others are in the planning and development stages.

Canada has a large natural gas potential

Canada’s ultimate natural gas potential is large and underdeveloped. Canada’s National Energy Board estimates the ultimate potential of the Western Canada Sedimentary Basin to be 335 trillion cubic feet (Tcf) of which 121 Tcf has been developed. A further 323 Tcf of frontier potential is estimated and this is essentially untapped. Of that, 64 Tcf is in the Mackenzie Delta and 63 Tcf is off Atlantic Canada with the remainder in other frontier areas. The natural gas resources of Atlantic Canada have begun production. Sable Offshore Energy Project is currently producing over 400,000 Mcf per day, and the recent announcement of PanCanadian’s deep Panuke project will see more natural gas production from offshore Nova Scotia by 2005.

The large resources of the Mackenzie Delta – 9 Tcf discovered and 55 Tcf undiscovered – and the enormous resources of neighbouring Alaska – 42 Tcf discovered (so proved plus 33 reserve growth) and 195 Tcf undiscovered are expected to find their way to market within the decade. It is pipeline connection to market that is needed. The cost and risks of such a massive development will be undertaken when producers see the time is right because they bear the ultimate brunt of the costs and risks.

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1. The WCSB comprises Alberta, Northwest British Columbia, Saskatchewan, a part of Manitoba, and the Southern Northwest Territories and Yukon Territories. If the Northern Frontier and the Southern Territories portion of the WCSB are combined, the potential “North of 66°” is 125 Tcf of natural gas.


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Section C
Markets function within the frameworks established by government policies — a renewed policy effort is needed to foster market-oriented activity

Bringing on new supply requires supply-oriented policies

The rapid response of oil and natural gas supplies in the years following the first wave of market-oriented policies resulted in some complacency. There was a tendency to take for granted the continued ability of oil and gas producers to increase efficiencies, to absorb cost increases, and to manage the need to constantly expand areas of operations. The neglect has not been benign.

A strong economy has made possible the pursuit of any number of economic, social and environmental objectives. If we are to continue to be able to invest in these priority areas, we must ensure the economy, of which the oil and natural gas sector is a growth component, is placed on a stable footing. Above all, for the consumer, emphasizing supply-oriented policies is the one best way to address the current high price of energy.

Supply cannot be brought on if access to the resource is unreasonably withheld

Petroleum producers in both Canada and the United States share a common problem: the need to access new basins to maintain and increase oil and natural gas supplies is frustrated by policies that unreasonably withhold, or make excessively difficult and/or costly, access to the resource. Some potentially productive areas are effectively off-limits even though modern technology would allow responsible operations in these areas and other relevant considerations were addressed.

Other areas are subject to requirements of various kinds that add unnecessarily to the cost and timeliness of accessing the resource. In addition, while industry can be expected to engage in reasonable and early public consultation when developing projects, it is not always possible to satisfy everyone. There are situations in which the broader interests of society must prevail over individual objections.

Recognizing that governments sometimes declare areas off-limits to development, CAPP believes that, once development rights have been awarded, governments must support responsible access to the resource.

It is ultimately society that pays the cost of restricted resource access through reduced supplies.

Government policies can, and should, sustain and foster well-functioning markets. Conversely, policies that hinder and constrain, or render less efficient the functioning of markets, should be reformed.

The market cannot function without supply. A renewed political consciousness of the importance of supporting supply-oriented enterprise with supply-oriented policies is needed.
Permitting and approvals processes must be timely, consistent, predictable, efficient, and above all, respect market decisions.

Regulatory processes in both Canada and the United States have become unduly complex, confusing, time-consuming and costly. Regulatory requirements are layered one on top of the other. Duplication of effort is common, especially where multiple agencies are involved in environmental assessment of project approvals.

More attention needs to be paid to the coherence of the overall regulatory structure, the efficiency of its administration, and the capacity of staff. The assumption is that industry has infinite time and resources to respond to any amount of regulatory burden and that society suffers no loss through the process. The assumption is wrong. The costs both to society and to industry are lost opportunities to access resources and delayed responsiveness to the market’s need for greater supply.

There is no supply without investment

Government and tax and fiscal policies should encourage investment. Overall, fiscal policy should strive to achieve competitiveness compared to other jurisdictions and relative to other industries. Capital is highly mobile. In addition, differences in particular circumstances should be recognized.

Local municipalities and other local authorities also have taxation powers that can too easily frustrate broader fiscal objectives. The burden of local taxation has dramatically increased. This trend needs to be put in check.

There is no investment without reward; fiscal regimes must balance risk and reward

Royalty regimes must reflect a sharing of the risks and rewards of resource exploration and development. The share must, in addition to being competitive, also recognize the risk and the cost of the investment. Not all areas or operations have the same risk or cost profile. Oil sands development has a much different risk and cost profile from conventional oil extraction: initial investments are larger; lead times are longer; and production profiles are longer.

Likewise, frontier development has different characteristics. These differences must be recognized in royalty regimes. At the other end of the spectrum, marginal wells should not be prematurely shut in by unreasonable fiscal policies.

Technology change drives down costs, improves environmental quality, and expands the accessible supply.

Technological advancements have, as noted above, dramatically improved the cost effectiveness of the industry as well as expanding the known resource base. The environmental "footprint" of petroleum exploration and production has also been reduced. Society as a whole has benefited from these advances. There are significant opportunities for increases in energy efficiency and environmental sustainability.
Continued advances in technology require ongoing research and development in a coordinated manner. Governments already provide incentives for research and development (R&D). This should be done in a way that captures all the R&D activity contributing to technological change. For example, in Canada, the Scientific Research and Experimental Development Tax Credit fails to recognize the ongoing R&D activity of companies with operations broader than those which are purely scientific. The goal should be to facilitate technological change and improve competitiveness, not to reward particular forms of corporate structure.

Energy is too valuable to waste; conservation should be encouraged just as supply responds to price signals, so too does demand. Consumers have choices and they can make the right choices if they have the right information. Accurate market price signals provide that information. Why would anyone choose to reduce their energy demand, place any value in contracting for long-term price stability, or be prepared to support needed development if they are shielded from information that would influence their choices?

Government policies can also encourage conservation by providing incentives for investment in more energy-efficient vehicles, consumer appliances or home construction. Similarly, there may be a role for incentives where unusual costs are required to address a public desire for increased efficiency in methods of production or in energy-intensive industries.

Transmission: Market access depends on physical pipeline access

Overall expansion of oil and natural gas transmission capacity has kept pace with supply and market growth. Oil pipeline capacity is currently adequate to meet market needs. Additional oil pipeline capacity will be required as oil sands production increases. Natural gas pipeline long-haul capacity in the United States increased over 12 billion cubic feet per day (Bcf/d), or 17%, between 1990 and 1997. Canadian natural gas pipelines added over 6 Bcf/d of long-haul capacity to serve both domestic and export requirements between 1986 and 1998. Natural gas export capacity from Canada now somewhat exceeds the overall export supply. There is a demand for expansions to California and the Pacific Northwest. Pipeline capacity to the U.S. Northeast is also at its limits with several expansion proposals under consideration. Pipeline expansions in eastern Canada are also anticipated in response to the growth in demand for natural gas from offshore Nova Scotia.

The timeliness of regulatory approvals and the acquisition of needed rights-of-way remains a concern in both Canada and the United States. The regulatory policies at the provincial and state levels which govern the activities of local distribution companies also have an influence on pipeline expansions. Pipeline expansions require long-term commitments. Someone must pay for this over a very long time. Regulatory policies must support market-based commitments.
Major new pipeline development is required to access northern natural gas

Canada and the United States have long shared a common interest in the development of northern oil and natural gas resources. The market is signalling a need for a major expansion of the natural gas pipeline infrastructure in the North. As noted above, it is the market that will decide the timing of northern pipeline development. These decisions will be made in the context of the more integrated North American natural gas market and more integrated natural gas pipeline infrastructure that has emerged in the past 15 years.

The role of government is to ensure that regulatory processes are co-ordinated and that action on applications is timely. This requires a framework for inter-jurisdictional co-operation. Discussion of such a framework should include input from producers.

There is already a sound basis for Canada/United States co-operation. We have similar regulatory institutions applying similar regulatory concepts within a broad context of shared values. The Trans Pipelines Treaty ensures non-discriminatory treatment of pipelines transiting either Canada or the United States. The 1976 Northern Pipeline Agreement established a specific regime for handling the Alaska Natural Gas Transportation System (ANGTS). It remains to be seen if potential development would fit into the ANGTS framework. However, the Northern Pipeline Agreement underlines the importance of timely processes and inter-jurisdictional co-ordination and co-operation to address the interests of both Canada and the United States.

In Canada, the need for inter-jurisdictional co-operation and co-ordination also involves the various local jurisdictions in the North, such as territorial governments, aboriginal authorities, and various other agencies and boards.
Increased supply requires clear frameworks that address the interests of aboriginal and local communities

As development in Canada moves further into new or less developed areas, the need for clear frameworks that address the needs of aboriginal communities, including economic benefits, becomes ever more important. Industry has worked hard to establish good relationships and opportunities for training and employment with aboriginal communities. However, government must take a leadership role in establishing these frameworks.

The needs of local communities must also be addressed as development proceeds. Too often local community concerns manifest themselves in the form of outright opposition and obstruction. A clear policy framework is required to balance the local with the broader interests of society.

Continental energy supply responses require consistent approaches to environmental issues both large and small

Similar high standards of environmental protection and enforcement for upstream petroleum operations are already in place in North America. As we move forward in developing more global strategies to address issues such as greenhouse gases, it is critical that we do so in a manner that recognizes the continental and global nature of energy supply and the increasing interdependence of our economies. We must ensure that environmental policy is developed within an economic context. Preservation of the high standards currently in existence in North America is a must.
D. Conclusion: What is needed

As we move forward in developing more global strategies to address energy production and consumption, it is critical that we do so in a manner that recognizes the continental and global nature of energy supply and the increasing interdependence of our economies.

Deregulation of oil and natural gas has been a success. The market works. What is needed now is a renewed policy effort to support development of untapped petroleum resources. These are required to meet North America's energy demand and to support development of additional infrastructure needed to bring more supplies to market.

Support means strategy and policy that are consistent with the operation of free markets and open competition, and provide the frameworks that facilitate responsible, environmentally sound development.
Elements of the Needed Policy Frameworks:

- Primacy of free trade and open competition.
- Producers and consumers must receive accurate market price signals.
- Respect and support freedom of contract and contract sanctity.
- Let the market decide the pace, scale, form and path of development.
- Build on the fundamentals of the FTA and NAFTA to increase national treatment of energy investment and energy commodities.
- Establish the development of energy supply as a policy priority among the highest orders of social and economic value.
- Encourage conservation and reduction of waste.
- Facilitate reasonable and responsible access to the resource.
- Reform the administration of regulatory policies to eliminate layering and duplication of requirements and to achieve timely, effective and efficient permitting and approval processes.
- Co-ordinate environmental policies and strategies.
- Ensure tax and fiscal regimes are competitive and also reflect the actual characteristics of the particular industry.
- Tailor royalty regimes to the risk and cost profile of the resource activity and to the decline profile of the resource.
- Encourage research and development to continue to drive technological change.
- Facilitate needed pipeline expansions through timely, stable decision-making and support for long-term market-based commitments.
- Ensure coordinated and timely action for the development of frontier natural gas within a framework of inter-jurisdictional co-operation, recognizing the market will decide timing, routing, size and other aspects of development.
- Establish frameworks that address the needs of aboriginal and local communities within which development can proceed with clarity and certainty.

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