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Chair

Mr. James Rajotte

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● (0845)

[*English*]

The Chair (Mr. James Rajotte (Edmonton—Leduc, CPC)): I call this meeting to order.

This is meeting 70 of the Standing Committee on Finance. Our orders of the day, pursuant to Standing Order 108(2), are for a study of the impact of low oil prices on the Canadian economy. This is our first meeting on this topic.

I want to welcome our witnesses here in Ottawa. We're also expecting a witness in Edmonton for this first panel.

From the Canadian Association of Petroleum Producers, we have the president and CEO, Mr. Tim McMillan. From the Canadian Fuels Association, we have the president and CEO, Mr. Peter Boag. From Encana Corporation, we have Mr. Richard Dunn, vice-president. From Suncor Energy Inc., we have the executive vice-president, Mr. Steve Reynish. Welcome to the committee everyone.

We are expecting Gil McGowan, the president of the Alberta Federation of Labour, in Edmonton. Hopefully he will arrive in time for his presentation.

You each have five minutes maximum for your opening statement, and then we'll have questions from members.

We'll start with you, Mr. McMillan. Please begin.

Mr. Tim McMillan (President and Chief Executive Officer, Canadian Association of Petroleum Producers): Thank you, Mr. Chair.

Thank you to the committee members for inviting CAPP to be part of this presentation.

I'll start off by introducing CAPP briefly. Then I'll move on to the effects of the current price environment on our industry and the effects we think that will have on Canada.

CAPP represents the upstream oil and gas producers in Canada; 90% of all the oil and natural gas produced is from the members of the Canadian Association of Petroleum Producers. We are by far the largest private sector investors in Canada. In 2013 we had about 74 billion dollars' worth of investment in building the Canadian economy, and in 2014 about $70 billion. Out of that we've seen $18 billion a year, on average, contributed to governments for taxes and royalties over the last several years.

We make up 20% of the stock market, or at least we did until six months ago. With the current price environment, that has reduced to about 12%. We are 20% of Canada's exports. We employ over half a million people. Our supplier network reaches really across the country with more than 2,500 suppliers to the energy sector.

Price volatility in the commodity market is the norm, not the exception. Our industry has been through high and low price environments in the last several decades. We as an industry are actively positioning ourselves right now. You will see those effects really across Canada to ensure that we can be successful in the medium and long term, and Canada can maintain its strong position as a supplier of choice in the world for energy products.

The Bank of Canada came out in January and made some statements around the effects of the low price environment on the Canadian economy. I'll quote the bank, “The considerably lower profile for oil prices will be unambiguously negative for the Canadian economy in 2015 and subsequent years.” The effect of the low price we think will be felt across Canada—through our supplier network, through the employment that is sourced from across the country, and through the taxes and royalties that are paid to really all levels of government and across the country.

Getting into the specifics of what our expectations are, we put out an interim report in January updating our annual report on investment expenditures. In January we said that we saw a 33% reduction in capital expenditure in 2015. We've seen that further eroded in the last few months. With those public statements from January, we would break it apart to about a 40% reduction in conventional oil and gas and about a 25% reduction in oil sands investment. The reason for this is that oil sands investments are multi-year and larger projects. Projects that are in years two, three, four, or five will get ongoing investment and will be brought into production. The western tight oils will have a production profile that is higher at the front end and declines more rapidly, and the time from drilling to production is so much shorter that it can be far more elastic with price sensitivity.

We also want to be clear that even with the lowering of investment by 33%, going from over $70 billion to below $50 billion, we will still be by far the largest investor in the Canadian economy. The effects that will have on production in the short term I think are clear to point out as well, because they aren't always obvious. We would expect to see a reduction in production from what we had predicted, but the Canadian energy sector is going to continue to grow production even in the current environment, even with the lower investments. The numbers we put out in January predict about a 150,000 barrels a day increase in 2015, and in 2016, roughly 190,000 barrels a day. As I said, those were a snapshot in time in January, but we are looking to increase production regardless of the current price. We want to ensure that our industry is strong in the long term and that Canada maintains its position as a supplier of choice around the world.

Thank you for the time here this morning.

● (0850)

The Chair: Thank you very much for your presentation.

We'll now go to Mr. Boag, please.

Mr. Peter Boag (President and Chief Executive Officer, Canadian Fuels Association): Thank you, Mr. Chairman.

Members of the committee, good morning, it's my pleasure to be here today.

I represent the refining sector, which is an integral component of Canada's petroleum value chain. Refineries are the manufacturing intermediary between crude oil and refined products. Canada has 18 refineries located in eight provinces, with a total capacity of two million barrels per day. They contribute $5.6 billion in direct GDP and employ more than 18,000 Canadians.

The refining process simply separates, breaks, reshapes, and recombines the molecules of crude oil into value-added products such as gasoline, diesel, and aviation fuel. These transportation fuels typically account for 75% of refinery output, the remaining 25% comprises heating oil, lubricants, heavy fuel oil, asphalt for roads, and feedstocks that the petrochemical industry transforms into hundreds of consumer goods and products that Canadians use and rely on every day, from plastics to textiles to pharmaceutical products.

Crude oil is the single biggest cost input for refiners. Over the long term, refined product prices for gasoline, for example, generally track movements in crude prices although other factors can come into play. The difference between crude oil and the price of gasoline at the pump comprises three components: the refiner margin, the marketers' margin, and taxes. The decline in crude oil over the past six months has been accompanied by a significant decline in retail fuel prices. The current Canadian average retail price of gasoline is about 20¢ per litre lower than it was a year ago.

I've handed out a document, the Natural Resources Canada “Fuel Focus” report. It's from last Friday, March 6. If you look at figure 1 on page 1, it shows on a national basis how retail prices for gasoline have closely tracked crude prices into February of this year. The overall trend line for refiner and retail margins has not materially changed over the past months.

If you look at figure 5 on page 4, and I'm looking specifically at the chart in the upper left, it shows that beyond typical, short-term variations in refiner margins, and that generally reflects seasonal demand changes and other short-term gasoline supply and demand dynamics, there's been a modest downward trend in refiner margins over the past two and a half years, on a national basis. The retail margin trend, again on a national average basis, has slightly increased. As you can also see from the chart, refiner margins significantly dipped in January. Gasoline margins were under significant downward pressure over this time not only because of seasonal demand changes but also because of a surge in production resulting from North American refineries running at very high utilization rates.

Relatively inexpensive crude prices and a refined product futures market indicating higher future prices compared to current spot prices caused refiners to process more crude and store more refined product for future sale. This resulted in bulging gasoline inventories that were well above their seasonal norms, accompanied by lower margins. In the past month, the national average refining origins on gasoline have increased materially. There are several factors behind this: a confluence of recent refinery-related issues, in particular, strikes at several facilities in the U.S.; a major, unplanned outage at a major U.S. west coast refinery; and weather-related issues at several refineries in the eastern U.S. and Canada. Combined with short-term maintenance shutdowns, normal at this time of year, the supply side of refined products has tightened significantly leading to an increase in wholesale prices and refining margins. Another major factor is the record refined product exports from the U.S., in particular for gasoline in the last two months.

However, increasing wholesale prices and refining margins for gasoline are common at this time of year. Despite all the refinery and supply-related issues this year's seasonal increase in refining margins is consistent with historical norms. Current refining margins for gasoline aren't materially higher than they have been throughout the first quarter of the previous three years. Diesel prices have also generally tracked the change in crude prices, although to many this may have been masked by the recent price difference between diesel and gasoline.

Disparities between retail gasoline and diesel prices are normal phenomenon driven by different seasonal demand patterns of two very distinct commodities. Gasoline demand peaks in the spring and summer, while diesel demand peaks in the winter due to its close relationship with heating fuel.

Since 2008 Canadian diesel prices have averaged nearly 7¢ per litre more than gasoline during the period of November to February, while averaging nearly 4¢ per litre less than gasoline from May through August.

● (0855)

Seasonal disparity between the two products has been much more pronounced in recent months and that's largely because of the significant decline in gasoline margins that I previously mentioned. In fact, diesel refining margins remain virtually unchanged from where they were at this time last year, and the gap between diesel and gasoline has already begun to narrow as we move from winter into spring.

In conclusion, lower crude prices have resulted in lower fuel prices. Moreover, according to Statistics Canada's most recent data on consumer prices, overall transportation costs declined 5.3% in the 12 months to January 2015 as fuel prices declined.

Thank you and I look forward to your questions.

The Chair: Thank you very much, Mr. Boag.

Mr. Dunn, please.

Mr. Richard Dunn (Vice-President, Canadian Government Relations, Encana Corporation): Thank you, Mr. Chairman.

Good morning. I'm Richard Dunn, vice-president of government relations for Encana. Encana is a significant upstream producer in Canada. Thank you for the opportunity to speak today on how the global oil price decline has impacted Canada's energy sector, and the challenges and the opportunities we see going forward.

The current low commodity price brings into sharp focus the importance of industry and government working together to ensure Canada maximizes the long-term economic opportunity presented by our natural resources. To do so demands a partnership approach with industry continuing to adapt and innovate, and government continuing to take steps to ensure economic competitiveness.

As Tim McMillan of CAPP noted, the impacts of a low price environment are being felt across Canada. The Bank of Canada estimated that energy-related capital investment declined significantly in 2015. Already, energy companies, including Encana, have reduced their investment by billions of dollars, affecting the bottom lines of governments, businesses, communities, and individuals across the country.

No one has a crystal ball; however, some observers believe the market may begin to rebalance toward the end of 2015. The question remains, what's the new balance point?

Just as we did not believe that $100 oil was sustainable, we don't believe that $50 oil is sustainable either. Collectively, industry and government need to find ways to thrive at a range somewhere in the middle and to transition to a more realistic long-term modest oil price environment.

Industry will continue to respond with versatility and innovation. In Encana's case, we have exercised strict financial discipline, increasingly focused our investment on our core strategic assets, and lowered our costs through operational efficiencies, technological innovation, and working with our supply chain. We've exercised financial discipline by reducing our 2015 capital investment by some $700 million, $300 million of which is in Canada.

As part of our focus on efficiency and operational excellence, we are employing new technologies to maximize production and minimize our environmental footprint. This includes pad drilling, which optimizes our land uptake, and the use of saline water sources for hydraulic fracturing, thereby minimizing our fresh water use. To be clear, operating in an environmentally responsible way is non-negotiable. Put another way, responsible development will not be compromised in a low price environment.

These are just some of the ways in which Encana is dealing with $50 oil, and I might add, dealing with a sub-$3 natural gas price environment as well. We have an opportunity to work together to meet the challenges of the low commodity price cycle and ensure that Canada prospers over the long term.

I've talked about what industry is doing. I'd like to touch upon the pivotal role that government plays.

I believe it's more important than ever for government to find opportunities for Canada to increase its competitiveness by focusing on critical infrastructure, a competitive fiscal environment, regulatory efficiency, first nations engagement, and public acceptance for resource development. I'll touch on those points.

Canada must continue its strong efforts to put in place critical infrastructure for global market access, including LNG, in order to realize our full resource potential. For companies, there is an urgency attached to capital decision-making, and in order to maximize Canadian investment going forward, it is crucial we expedite these infrastructure projects.

We must continue to focus on the fiscal environment. The federal government's recent announcement of a tax reclassification for LNG projects is a great example of a fiscal measure that positions Canada as an attractive and competitive place to invest.

On the regulatory front, we encourage the government to continue to address legislation and regulations that risk putting Canada at a competitive disadvantage. In order to carry on with our shared mandate of responsible resource development, we need to maintain the right balance of environmental protection and economic competitiveness in policy and regulation. This is not about lowering environmental standards but rather about ensuring that our regulatory review processes are as efficient as possible.

With respect to first nations, ongoing government leadership is imperative on a number of fronts, including bringing greater clarity to the consultation process and improving first nations capacity. Government leadership is essential to creating an environment of shared economic prosperity, one which will provide greater investment certainty while at the same time creating opportunities for aboriginal communities.

Finally, and importantly, together we need to continue to earn public trust for resource development. Both industry and government have leadership roles to play in bringing balance to the discussion. Our shared voice must help the public understand how the energy sector's success translates into success for all Canadians.

In conclusion, we believe the time for collective and unified industry and government action is now. A low commodity price environment affects people across the breadth of this country. This is a national issue with national implications and nationwide generational opportunities.

● (0900)

Working effectively together, we can play our parts in ensuring that all of Canada benefits and prospers in this low commodity price environment and is well-positioned for the anticipated price recovery.

Thank you.

The Chair: Thank you, Mr. Dunn, for your presentation.

We'll go to Mr. Reynish now, please.

Mr. Steve Reynish (Executive Vice-President, Strategy and Corporate Development, Suncor Energy Inc.): Thank you, Mr. Chairman, and good morning, everyone. I appreciate the opportunity to appear before you today. My name is Steve Reynish and I'm with Suncor Energy.

As I'm sure you know, Suncor is one of Canada's leading integrated energy companies, employing thousands of Canadians from coast to coast. Our operations include oil sands development and upgrading in northern Alberta as well as conventional and offshore oil production. We own and operate refineries in Edmonton, Sarnia, and Montreal, as well as a lubricants plant in Mississauga. We are also active in renewable energy with interests in seven wind farms, and we operate Canada's largest ethanol plant in Sarnia. Many Canadians know us as “Canada's gas station” through our 1,500 Petro-Canada locations.

I think the first point I'd like to make is fairly obvious to everyone in the room. The world has changed significantly, with oil prices having dropped something like $50 per barrel over the last number of months. I see this morning that WTI is trading again under $50 a barrel. There's no doubt that this will have an impact on the industry and the Canadian economy. For Suncor, every $10 change in the price of oil per barrel equates to over a billion dollars in cash flow.

At Suncor, we've been preparing for this downturn in prices, and what we see is a return of volatility to these markets. We think we are positioned reasonably well thanks to a clear strategy. The fundamentals of that strategy are simple: optimize our base business, pursue profitable growth, return cash to shareholders, and be an industry leader in sustainability. This strategy is underpinned by a commitment to capital discipline.

We've been taking a hard look at our costs for the past couple of years, and these lower prices have caused us to accelerate those efforts. We've reduced our capital budget for this year by a billion dollars, and we're looking for $600 million to $800 million in operating budget savings over the next two years. I think you may have seen that we've also announced a reduction in our workforce of a thousand positions. Let me emphasize that these reductions were made in a way as not to jeopardize safety or environmental performance.

Others in our industry with higher debt or limited cashflow may not be in the same financial position. Their situation highlights the very real effects of the downturn on the Canadian economy. Let me just run through a few examples of that.

With respect to the oil supply-demand balance, lower prices will stimulate demand for energy—and we've seen this particularly already in the U.S.—but producers' cashflow obviously will be negatively affected, forcing cost reductions.

On the employment side, declining revenues will also limit our ability to sustain a stable labour force. Our strategy, however, remains to look for local labour first, then regionally, then nationally, and then only as a last resort do we look internationally. The current environment has allowed us to source closer to home, and we are reducing or eliminating higher cost fly-in, fly-out labour to our operations. Significantly, lower prices have rationalized the most expensive labour option for us, which is temporary foreign workers.

In terms of capital investment, companies are shelving projects in light of the new price environment. That of course impacts engineering, construction, and the operation of projects. The declining Canadian dollar softens the blow somewhat for Canadian operators but does not completely offset the decline in oil prices. For us at Suncor, a lower dollar is a double-edged sword. Our earnings are in Canadian currency but our debt is largely denominated in U.S. dollars.

Regarding the supply chain, lower prices also impact spending in other sectors including transportation, manufacturing, hospitality, tourism, and high tech. I think in Canada's case that list is a long one. Of course, depressed oil prices also result in lower taxes and royalties.

• (0905)

Overcoming this challenge will require a sustained effort for all of us. For us in industry, it means focusing on reliable, safe operations, and reducing costs. For contractors and suppliers, we are looking for them to help us find creative ways of reducing costs. For government, we think it means ensuring a strong, cohesive policy framework is in place to facilitate future development. We're particularly interested in any potential cumulative effects of taxes and regulations.

I'll leave it there. Thank you, Mr. Chair.

The Chair: Thank you very much for your presentation.

We will now go to Gil McGowan in Edmonton, from the Alberta Federation of Labour, and then we'll go to members' questions.

Mr. Gil McGowan (President, Alberta Federation of Labour): Mr. Chair, I've done this before so I know how quickly the time goes. I'll dive right in. I have six observations and seven recommendations.

Observation number one is that the fall in oil prices has been precipitous. There's no doubt about that, but no one should be surprised. Oil prices go up and they come down, and you can't say that something is a crisis or an emergency if you knew it was going to happen sooner or later.

Observation number two is that we are not in uncharted territory here. If you adjust for inflation, the average price for oil over the last 40 years has been actually $50 a barrel, almost exactly where we are today. Any company that assumed prices would stay at $100 a barrel forever, frankly, was being unrealistic.

Observation number three is that we probably need to get used to this price range. The factors that led to the current glut are still in place. International demand is low. Production is still high and showing no signs of slowing. Of course, we have new technology that is reshaping the oil market in the same way that similar technology reshaped the global and regional natural gas markets about a decade ago, which resulted in long-term price declines for natural gas. We can expect something similar in terms of oil.

Observation number four is that the drop in the price of oil has been bad for some Canadians, but good for others. It really depends where you work and where you live. Obviously, it's good for consumers because the price of energy is down. It's also good for some manufacturers because of the lower dollar. That cannot be lost in this discussion.

Observation number five is relates to the labour market in Alberta. The effect of oil prices on jobs has been variable, even in Alberta, and even within our energy sector. The reality is that our energy sector is actually a grouping of industries, at least three different sectors within a sector, so drilling and oil field service, for example, have been hit very hard because companies always respond to low prices by ramping down capital investment very quickly. We've seen that and that's already resulting in dramatic job losses for drilling and oil field service.

The second sector within a sector is oil sands-related construction. Our concern for our members is not right now. Most of our members are working on projects where funding was approved before the price of oil dropped. The big question is what will happen for the next generation of oil sands projects if the price remains where it is right now, but for now, most of our guys are working.

The third sector within the sector is downstream value-added production, so upgraders, refineries, and petrochemical. One of the things we always point out is that during periods of low oil prices, employment in these downstream sectors remains very stable. It's one of the reasons why we always encourage more investment in the downstream because it provides stability even when prices are dropping.

In addition, a lot of our members in construction are finding work this year in what we call shutdowns and turnarounds, which are basic maintenance on existing energy facilities like upgraders and refineries. This just happens and the timing is very good as this happens to be a year with a lot of shutdown and turnaround work, so it comes at a very good time. There's also a lot of commercial work in Alberta right now, so the effect of oil prices on the construction sector is muted.

Observation number six is that I urge members of the committee not to put a lot of stock in what I describe as disaster rhetoric. Winston Churchill famously said that you should never waste a good crisis and that's what's happening with some people who are speaking out with a lot of gloom and doom about the oil sands right now. For example, we heard the president of Canadian Natural Resources talking about a death spiral in the oil sands one day and the next week he was announcing $3.9 billion annual profits. We also hear our premier singing from the doom and gloom song sheet.

I would argue that things are really not that bad and people like our premier and the president of CNR are simply using this crisis as Winston Churchill suggested to take advantage for their own self-interests. In the case of Canadian Natural Resources, they're trying to use the crisis to squeeze contractors. When it comes to the premier, he's trying to squeeze public sector workers.

In terms of recommendations—

• (0910)

The Chair: Mr. McGowan, you have about 30 seconds left.

Mr. Gil McGowan: Okay.

Number one, don't panic. Number two, abandon the fixation on pipelines. It simply doesn't make sense to pump more oil into glutted markets. Number three, repair our social safety net. Our unemployed workers are going to need it. Number four is tax reform. You can ask me about that later. Number five, focus on more value-added production for three reasons: because it provides stable jobs, as I talked about; because it's cheaper to build now; and because our feedstock costs are lower.

I guess I'm out of time. I have a couple more recommendations, and I'd appreciate it if the committee members would ask me about them.

The Chair: Thank you for your presentation.

We'll go to Mr. Cullen first.

Colleagues, if we stick to our time limits we can do the first four members at seven and then the rest at five minutes.

Mr. Cullen, you have seven minutes, please.

Mr. Nathan Cullen (Skeena—Bulkley Valley, NDP): Thank you very much, Chair.

Thank you to everyone for being here. Thank you, Mr. McGowan, for being up a couple of hours even earlier.

All of us politicians like to think we're more influential than we are. I'm reading the quote from the former MP from Fort McMurray who said that he'd like to see it all slowed down, that they have two-hour waits in the morning and the oil sands aren't going anywhere. He said, “Let's manage it properly.”

If I were to try to find a theme through what I heard this morning, it's that there's a change in the profile for the companies in terms of investment decisions.

I want to start with you, Mr. Dunn. From your company's perspective, from Encana's perspective, this is a time when extras are being taken off the books. You're looking to save money. You're looking to keep things nimble and lean. Is that a fair assessment in terms of where the company is at?

● (0915)

Mr. Richard Dunn: Certainly we have a number of strategies that look to weather the storm that we're currently going through, and the dip, and then position ourselves for the longer term, as mentioned.

Mr. Nathan Cullen: In weathering that storm you've committed to certain projects and certain investments. For anything more speculative, anything a little bit more venturing, this is a time when the cashflow determines that some of those projects get pulled back. You have to make assumptions about where the market's going to be. I put this to both Suncor and Encana. Do you folks assume the price that we have today, in terms of projecting forward through your spending plans right now?

I see Mr. Reynish nodding.

Mr. Steve Reynish: The quick answer to that is no, we don't. We look at short-term prices. We think for 2015 we're going to be in similar pricing to what we see today.

Mr. Nathan Cullen: Right.

Mr. Steve Reynish: I think we do see some form of recovery, post this year. Then, of course, we look at the long-term price. From that we would have higher than today's price.

Mr. Nathan Cullen: I'll hear Mr. Dunn's comments on this, and then I'll want to turn to Mr. McGowan.

The prudent or conservative approach, in terms of your own budgeting and what you're looking at, is not to assume a return to $100 oil by the end of year. The more conservative approach is what? Do either of your companies take an assumed price of barrel?

Mr. Richard Dunn: As mentioned, we don't believe that either $50 or $100 is sustainable and there'll be some point in the middle that ultimately will be landed on. Our strategy is to focus on those quality properties that will be worthwhile to develop at some midpoint price.

Mr. Nathan Cullen: I ask this in part because looking through the last report from TD Economics their assumption was that the government, in its own estimates for revenue and the economic update of this past November, took the price of the day and made that assumption in terms of what kind of revenue the federal government would receive from the industry. Is that considered, from your perspective, a prudent approach to take? It's not speculative, I suppose. You take what you have in front of you. The government did that in November in its update and its forecast. Does that seem like a prudent way to go, Mr. Reynish?

Mr. Steve Reynish: I would say that is one data point. We would look at a range of different viewpoints and different data points. The one thing we do know is that none of us can predict a spot price for oil at any time in the future.

The one point I would make is that we believe that we've seen the return of volatility. That will make estimating an average price or spot price increasingly difficult. We will see much more volatility than we've seen over the last three or four years; more akin to what we saw before that, which is quite a volatile price.

Mr. Nathan Cullen: I have a question for you, Mr. McGowan. You cited a statistic that the $50 barrel is.... I didn't quite catch what your average was and what timeframe you were using. I assume it was under adjusted dollars.

Mr. Gil McGowan: It was forty years.

Mr. Nathan Cullen: Over how long, sorry?

Mr. Gil McGowan: Forty years when you adjust for inflation.

Mr. Nathan Cullen: Yes, adjusted for inflation.

You have spoken somewhat differently about the current price of $50, the investment decisions being made, and the impact on the federal treasury. You also talked about not using disaster rhetoric. What is the most important—if you want to use the term—opportunity in the crisis that you think the federal government should be looking to take advantage of?

● (0920)

Mr. Gil McGowan: I think the federal government, the provincial government, and industry should look at this low price environment as an opportunity to do what they should have been doing for the past 10 or 20 years, which is to move up the value ladder. Almost all of the current development in the oil sands is what I would describe as “rip it and ship it“ development, designed for raw export. There's no doubt that there was a lot of money being made with that approach when oil was trading at $100 a barrel, but what was being lost was an opportunity to create value here in Canada through the construction of new upgraders and refineries.

Mr. Nathan Cullen: On that subject, how many upgraders and refineries have we built in, say, the last 20 or 30 years in Canada?

Mr. Gil McGowan: Of the current generation of oil sands projects, only a handful are what I would describe as value-added. We have the North West upgrader that's just started construction, the latest phase of the Canadian Natural Resources upgrader. Almost everything else is raw export oriented. Part of the problem is that, in the last generation, there was no coordinated approach to development. It was sort of a gold rush mentality. Everyone was building at the same time. They were piling on. It drove up costs. We sort of priced ourselves out of the market in terms of more desirable, value-added development.

What I'm saying is that this low price environment presents us with an opportunity to go back to value-added projects for a number of reasons. First, the construction costs will be lower because the gold rush has ended. Second, I would argue that one of our competitive advantages when it comes to the oil sands is access to low-cost feedstock. Like it or not, bitumen trades below the price of light sweet crude oil. That's always going to be the case regardless of how many pipelines we build. We should just embrace that advantage.

The Chair: Mr. McGowan, could I get you to wrap-up, please? We're over Mr. Cullen's time.

Mr. Gil McGowan: Yes.

The essential point is that this should be seen as an opportunity to build value-added projects because costs are lower, feedstock is cheaper, and by building these projects, we create the kinds of jobs that we need to sustain us through this period of volatility that your other speakers have talked about.

The Chair: Thank you, Mr. Cullen.

We'll go to Mr. Saxton please.

Mr. Andrew Saxton (North Vancouver, CPC): Thank you, Mr. Chair, and thanks to our witnesses for being here today.

Listening to Mr. McGowan reminds me of that Supertramp album from the 1970s *Crisis? What Crisis?*, but that's another story for another day.

My first question is for Peter Boag from the Canadian Fuels Association.

Has a drop in oil prices, like the one that we're experiencing now, been experienced before, and if so, when?

Mr. Peter Boag: Most recently, the drop in oil prices that came after the 2008 financial crisis would certainly be another example of the kind of drop that we've seen over the last six months.

Mr. Andrew Saxton: Can you tell us, what the effects on the economy were at that time, and how this time is different or similar?

Mr. Peter Boag: It is difficult for me to talk about this specifically in any great detail, but I think we all saw the impacts on the economy in terms of a slowdown and job loss. Canada was relatively well insulated compared to other economies around the world. We were very well positioned fiscally as a nation. While we certainly did see a dip and a minor recession, the impacts in Canada, on an economy-wide basis, were far less than those experienced by most other countries in the OECD and the in G-7 for that matter.

Mr. Andrew Saxton: Thank you.

My next question is for Tim McMillan of CAPP.

Oil prices are naturally volatile, but has the recent drop been an anomaly? Is this time different?

Mr. Tim McMillan: I think in a commodity market the volatility is something that comes with the territory, be it fertilizer, grain, or oil and gas. It's something that is a part of being in business.

If there's a difference, it's that 2008-09 was largely a low-cost environment due to the world economy slowing down. The one we're seeing this time is that the productive capacity of the energy production sector through the use of technology has gotten better. We have too much supply on the market, driving the price down as opposed to a demand side.

● (0925)

Mr. Andrew Saxton: What does the current drop mean to the importance of diversifying our markets for our oil products?

Mr. Tim McMillan: Being it's a world market, everyone in the world that's producing oil has the same world price. The differentials between light and heavy certainly have an effect. The ability to get our products to market is a challenge. It's something I think was important at $80, $90, $100 a barrel. It's an imperative that we have these type of efficiencies at $50 a barrel.

In Canada from Quebec and eastern Canada they import 60% of their oil from offshore—Angola, Azerbaijan, Norway. I think if we're looking at Canada, Canadians should have access to Canadian oil.

Mr. Andrew Saxton: Right, but we only have one customer for the export of our oil, which impacts the price that we can sell it at, so that's my question. How will diversifying our markets impact the price we can get for our oil?

Mr. Tim McMillan: It's very important. Over the last few years we have seen the differential between Brent, the price of oil off the U.K., at sometimes substantially higher prices than what we're getting in western Canada. Those in eastern Canada in Quebec are paying Brent prices while Canadians producing oil in western Canada are getting West Texas prices. Both are being disadvantaged.

If we could connect Canada and have access to both eastern Canadian markets and markets in Asia, India, and around the world, it would be very meaningful to not just our industry but our country.

Mr. Andrew Saxton: Thank you.

My next question is for Richard Dunn from Encana.

Richard, what impact would pipelines to tidewater have on the oil industry?

Mr. Richard Dunn: Certainly the access, as Tim rightly mentioned, the ability to realize a world price for our products certainly on the crude side....

On the natural gas side of things Canada has well in excess of 200 years of supply, and we're rapidly becoming constrained in western Canada with respect to opportunities to deliver into the United States. So in order to not only realize the opportunities that world natural gas LNG prices present, but also to expand our industry and grow our industry, access to tide water is critical for natural gas as well.

Mr. Andrew Saxton: How much is rail picking up the slack that would otherwise go through oil pipelines?

Mr. Richard Dunn: It's certainly increasing. I don't have that number at my fingertips, but certainly rail has increased dramatically in the last few years.

I would look to Tim. He may have those figures.

Mr. Tim McMillan: It has been very meaningful in certain locations. In Saskatchewan we've seen it ramp up from almost zero, three or four years ago, to today where 15% to 20% of the oil leaving our province leaves in railcars.

In North America in some places it's even far larger than that. North Dakota is sending, I believe, the majority of the oil produced; over half in North Dakota leaves their state in railcars. It is picking up the slack in North America where pipeline capacity is challenged.

Mr. Andrew Saxton: If there were pipelines in place then more oil could be transported obviously than what's being transported by rail today, correct?

Mr. Tim McMillan: I think rail has been an important part of today getting our product to market, but there are advantages to having more pipe in the ground, which I think would be a benefit to our industry.

Mr. Andrew Saxton: What are the risks of transporting by rail versus by pipeline?

Mr. Tim McMillan: We feel strongly no matter how our products get to market, it needs to be done safely. Rail is a safe option to move product to market. Pipelines are a safe option. Some oil travels on the road in trucks, and that needs to be done safely as well.

Regardless of the mode the high standards need to be set.

Mr. Andrew Saxton: Thank you.

Finally, my question is for Steve Reynish at Suncor.

What impact has the lower oil prices had on your plans for investment in the industry?

Mr. Steve Reynish: They certainly have impacted the plans.

I think there are two parts to the answer. One is that we have deferred two fairly large projects as a direct result of the current downturn. We hope to, and I think we will, pick those back up in subsequent years. On the other hand, we have two major long-life projects, in terms of Fort Hills in the oil sands, and Hebron off the east coast of Canada, which we are continuing to invest in.

We've deferred some and we're pursuing and maintaining others.

● (0930)

Mr. Andrew Saxton: Thank you very much.

Thank you, Mr. Chair.

The Chair: Thank you, Mr. Saxton.

Mr. Brison, please.

Hon. Scott Brison (Kings—Hants, Lib.): Thank you for joining us today and for your testimony.

Mr. McGowan seems to be issuing a challenge to companies, Encana and Suncor, that we could be doing more value-added and refining in Canada. What are the market impediments to making that happen?

Mr. Steve Reynish: I'll talk for Suncor.

I would say first of all that we do a lot value-added, so we do run upgraders. As I mentioned at the start of my comments, we are in the refining business, so we like to add value wherever we can within Canada. One example where we'll be able to improve that I think is the reversal of Line 9 and being able to take crude oil into our Montreal refinery. We see that as a positive step.

It is a complicated calculation in terms of market balance and where existing refinery operations exist and where markets exist. We'll do it where we can, but I don't think it's a one-size-fits-all blanket comment that it can be done everywhere.

Hon. Scott Brison: Mr. McGowan's message fits on a bumper sticker; yours is more complicated. We're kind of in the complicated business up here, so further information would be helpful so that we can understand what the market reasons might be and why you're not seeing a ramping up.

Mr. McGowan is saying that we should increase focus on value-added production in Canada now and not proceed with more pipelines.

Are these two mutually exclusive? Could we not build pipelines now and take advantage of low bond yields, a soft employment market, a soft economy, and build market access infrastructure now for the future? Is now not the ideal time to build that market access infrastructure while the economy is so soft and money is so cheap?

Mr. Steve Reynish: I'll let others comment on this as well, but I would say that this is a good time for building additional market access. I think it does have some implications for value-added as well as export.

Hon. Scott Brison: Mr. McGowan, some of your members would have an opportunity to work in helping to build some of these projects. In the U.S., there have been some labour unions that have been supportive of the Keystone XL pipeline, for instance.

Would market access that brings a higher price for Canadian petroleum and more jobs to your members not be a positive thing?

Mr. Gil McGowan: Let me respond to that in two ways.

First, when it comes to job creation, the kinds of projects you're building matters. Certainly, if you're building pipelines, jobs will be created, but in much smaller numbers and for a much shorter period of time than if you were building a big industrial plant such as a refinery or an upgrader. It depends on the project, but when you're building a pipeline you are talking about hundreds of construction workers over a period of a year or two, whereas when you're building a refinery you are talking about thousands.

In addition, once you've built a refinery you're creating long-term employment over the life of that facility, not just for the people in operations but also those in construction maintenance. I talked about turnarounds and shutdowns and regular maintenance. We employ literally thousands of construction workers—plumbers, pipefitters, and electrical workers—every year to maintain the existing plants. If you don't build the plant, that ongoing construction work is not there; it's missed.

I take issue with the argument that building pipelines to access new markets will automatically increase the price you get for the oil that you sell. Talk about bumper sticker arguments. That's a bumper sticker argument we have heard from the Alberta government and organizations such as CAPP for years and years. I have talked to economists and have sat through hearings in front of the National Energy Board hearing from experts, and it is not a given that, just because you connect our supply with the market overseas, the price will go up.

Look at the Asian market, for example. When you send bitumen over there, only 25% of their refiners can actually accept it as a feedstock, because they are what we call cracking refineries rather than coking refineries.

The market is really not as big worldwide as we've been led to believe. Light sweet crude oil can be used in every refinery in the world, but our product—bitumen—cannot be. Just sending it overseas does not guarantee a higher price. That is especially true now that there's a glut not just in the United States but on the global market. It seems ridiculous to me to say that dumping more product into a glutted world market is going to get us a higher price. I think most people would agree that dumping product into a glut is just going to maintain the price at a lower level for a longer period, whether it's Alberta doing it or OPEC.

● (0935)

Hon. Scott Brison: Mr. McMillan, how do you respond to Mr. McGowan's assertion that increasing production now is folly, given the pricing?

Mr. Tim McMillan: Did you say that production is falling?

Hon. Scott Brison: You were saying earlier that you're planning to ramp up production, which seemed inconsistent with the message from one of your members, Mr. Reynish.

Mr. Tim McMillan: We are expecting to see.... Investments are coming off, but projects are coming through the pipeline.

Hon. Scott Brison: Investment is coming off, but you're seeing production going up.

Mr. Tim McMillan: That's right. Some of the projects that are coming on stream in the next two years are projects that have been four or five years in the development and building. They may be in year three or four. When they come on, we will see the increased capacity of those projects. We're seeing, largely on the conventional side, flatlining in the coming one or two years. On the oil sands, we're seeing an increase because of large projects.

Hon. Scott Brison: What is the delta between oil sands production and, for instance, U.S. shale energy production and Saudi production. It strikes me that this is an important question, because if the Saudis are pursuing a low price agenda to try to squeeze out shale gas production in the U.S., the delta between oil sands production in Canada and shale gas production and their production is an important one for us to be cognizant of. What is the delta between these modes of production?

Mr. Tim McMillan: Each of them has a different cost profile. The shale involves projects in which you drill a well and get production very quickly, and the life of it is shorter than that of an oil sands project, which could be 20 years. However, each project is going to be different as well in the oil sands, from mining to in situ, based on the resource and many different parts of the project.

The Saudis have a substantial piece of the market and the ability to move the market, and that is what we're seeing here now.

Hon. Scott Brison: Mr. Dunn, you said that $50 WTI is not sustainable. If you look back to the nineties, when it was significantly lower, why would you say it is not sustainable?

Mr. Richard Dunn: As we mentioned, certainly in terms of the new techniques, those techniques have brought on a lot of supply, and they tend to be at a higher cost. In fact, Canada tends to have higher costs, whether it's—

Hon. Scott Brison: So production levels are not sustainable. The WTI may go lower, but you're saying that production in Canada may not be sustainable at that level.

Mr. Richard Dunn: No, what we're saying is that we expect that ultimately, once you work through some of the lagged production, prices will recover somewhat.

The Chair: Thank you.

We'll go to Ms. Bateman, please, for seven minutes.

Ms. Joyce Bateman (Winnipeg South Centre, CPC): Thank you very much, Mr. Chair.

Thank you to all of our witnesses. I very much appreciate your sharing your perspectives with us this morning.

One that was a recurring theme for many of you was the volatility in the industry. A few decades back, when I was articling at Price Waterhouse in the eighties, people were leaving homes in Alberta because of the market volatility. Obviously this isn't a new factor, notwithstanding some recent comments.

I want to tie that to the job perspective, because as a member of the Conservative government I take enormous pride that our government has created more net new jobs, and good quality jobs, than any other member of the G-7.

Suncor is a big industry. It's one in a very complex industry, but you mentioned that you have 1,000 fewer people now. I would love to find out, with the volatility, do you have a plan to bring back...? Is there an opportunity for these people to...? I would suggest that you have clearly invested in these people over the years, so how are you recouping that investment?

● (0940)

Mr. Steve Reynish: We did announce a reduction of 1,000 people. That is a combination of some part-time, some contractual workers, but it does include some full-time positions as well. You're quite right. There was a lot of investment that's gone on in terms of training and experiences being provided.

That's 1,000 out of our total workforce of about 15,000 people so that gives you the context around that. But it was done, I think, as a result of recognizing over the last couple of years—this is not just as a direct result of this downturn—that we have to move our cost profile down on the cost curve. We don't see this as a temporary phenomenon. We just need to get more efficient in the long term.

Ms. Joyce Bateman: Mr. Dunn, you wanted to speak to that as well.

Mr. Richard Dunn: I'd like to talk to that as well.

It's not simply the workers at our company. What's changed since the 1980s, I think, is the breadth of the impact of the industry on Canada. Whereas, as you said, in the eighties you would have seen an industry that was much more based in Alberta with its manufacturing and such, and the rigs. Now what you're seeing is an industry that is coast to coast, and this is through a conscious effort of companies.

There are some 2,300 suppliers across Canada that supply the oil and gas sector. These suppliers in manufacturing, whether it's valves outside of Montreal, tubulars in Ontario, or legal and professional services out of Toronto as well, are much more of a national industry. These reductions in activity go beyond simply employees in our company but broadly impact the services and supplies we get from the breadth of Canada. That's a significant difference from the 1980s.

Ms. Joyce Bateman: In that supply chain, and clearly that's a very complex supply chain, there is probably a bit of a time lag in terms of impacts.

Mr. Richard Dunn: Respectfully, no.

Certainly there is a difference in time lag between parts of the sector. The oil sands would be more bulky investments and as Tim mentioned, those investments are longer timeframes so if you're in the middle, likely you have a lot of sunk costs and you're going to continue.

Where I work, on the upstream side of things, as Mr. McGowan mentioned, we react very quickly to the change in commodity prices and that is instantaneous on our suppliers across Canada as well. We do not need the same level. This is why it's imperative that we do what we can to retain Canada's market share through actions of companies and actions of the government to set ourselves up for that retention and to keep the economy strong throughout Canada.

Ms. Joyce Bateman: I am so very glad to hear that and to hear about that instantaneous reaction and how important that is to job creation in Canada.

I want to build on what I believe was Mr. McMillan's earlier comment about Albertans selling at a low cost and eastern Canadians buying at a high cost. Maybe we could meet in the middle, and we'd all do better as Canadians. How can that happen? By having a pipeline from east to west, right?

Voices: Oh, oh!

Mr. Tim McMillan: I think that's part of it. We have seen rail connecting those two over the last couple of years.

If I could, maybe I'll address what Mr. McGowan spoke about, which was that the refining capacity might not be linked between the heavies and eastern Canada, but there's a very great link between the light oils we produce in western Canada and the eastern Canadian refineries.

Manitoba has become an oil producer. That is quite important to their province. Saskatchewan has increased its oil production in recent years, and there are the lights that are coming out of different fields in Alberta. Connecting those two with rail has been important. A pipeline would be a very important option as well. Also, potentially, export is always important to meet growing markets around the world.

Ms. Joyce Bateman: That's wonderful.

You made a comment, Mr. Reynish, and I think it was that for every $10 change in the cost of oil, there is a billion-dollar change in cashflow. Just quickly, could you expand on that? That's enormous.

● (0945)

Mr. Steve Reynish: It is enormous. Yes, that's the Suncor position, if you like. It's that a $10 change in the price we receive results in a billion-dollar reduction in our cashflow over a year. I think I was just trying to put some context around the scale of the issue.

Ms. Joyce Bateman: It speaks volumes to the economic impact of this industry in Canada.

Mr. Steve Reynish: I think it does. Of course, that just means there is less cash for services, as we were talking about. It impacts taxation. It impacts everything we do.

Ms. Joyce Bateman: That's for sure. Thank you so very much.

The Chair: Thank you, Ms. Bateman.

[*Translation*]

Mr. Dionne Labelle, you have five minutes.

Mr. Pierre Dionne Labelle (Rivière-du-Nord, NDP): Good morning, everyone.

My first question is for Mr. Reynish.

You spoke about rationalizing the workforce, and you mentioned 1,000 positions. If I've understood correctly, this rationalization is not necessarily tied to the drop in the barrel price, but rather to efficiency measures that you are thinking about keeping.

Have I correctly understood what you said?

[*English*]

Mr. Steve Reynish: Let me add to that. That was the announcement we made. It was 1,000. It's right across the company, so many locations around Canada would make up that number. What I was trying to describe was that this is part of a longer-term journey in terms of moving our cost profile down. However, there is no doubt that the current dip in oil prices has caused us to accelerate those measures and look at them more closely.

[*Translation*]

Mr. Pierre Dionne Labelle: I'm wondering about these layoffs. Will foreign workers be dismissed before Canadian workers?

[*English*]

Mr. Steve Reynish: No. Foreign workers are the last resort for us in terms of employment. We have very few. I think there are maybe a dozen or so foreign workers working for us currently. It's minuscule in the scheme of things. As I tried to point out in my opening remarks, we find that it's one of the higher-cost options for us in terms of labour, so our policy remains “the more local the better” in terms of employment, and then we move from there.

[*Translation*]

Mr. Pierre Dionne Labelle: That's what I think, too.

I will now move on to the volatility of oil prices from a consumer perspective. Mr. Boag explained some of that to us earlier.

I remember that in July 2008, a barrel cost $147, and we were paying $1.40 a litre at the pump. A barrel now costs $49, but let's round that up to $50. I recently paid $1.09 a litre at the pump. I'm wondering if consumers are really benefiting from the drop in the price per barrel. I don't find the cost per litre at the pump to correspond to the drop in the barrel price. I don't know why the drop in the price isn't proportional.

[*English*]

Mr. Peter Boag: As I indicated in my opening remarks, over the long term retail fuel prices do in fact generally track price movements in crude. Certainly, as we've seen over the last two and a half years, while there has been volatility in the price of crude oil there has been relative stability in refiner margins and retail margins. The prices at the pump have generally reflected movements in crude prices.

This is not to say that there are not short-term variations. Largely those display seasonal implications, as the supply and demand balance changes with the changes in seasons, as well as short-term supply and demand disequilibrium, whether from a demand spike or a supply shortage brought about by unplanned refinery outages or the kinds of situations we've seen in the U.S. recently, with a number of refineries shut down because of a strike. It is a North American market, not a uniquely Canadian market. Canada is 10% of what is a much larger North American market.

Going back to the 2008 experience, what you saw there was that while oil was going up as a global commodity, the price of fuel in North America was declining as a North American commodity as the impacts of the recession were starting to bite, particularly in the U.S. At one point in 2008, margins had dropped to zero and in fact were negative on the refining side because of supply and demand dynamics for gasoline that differed from the supply and demand dynamics globally for crude oil.

● (0950)

The Chair: Thank you, Mr. Dionne Labelle.

Next is Mr. Cannan, please, for five minutes.

Hon. Ron Cannan (Kelowna—Lake Country, CPC): Thank you, Mr. Chair.

Thanks to the witnesses.

It's always interesting. I used to have a retail gas station in Edmonton, about 25 years ago when the price was 39.9¢, and I have friends and family in Alberta, where the price was 60¢ over the last month. I was trying to figure out why, back in the Okanagan, we always have higher prices, and that's something we will continue to debate. But today we're here interested in discussing supply and world economic impacts on global pricing.

The first question is for Mr. Boag. You mentioned that there are 18 refineries in Canada, in answer to Mr. Cullen's question. There was a study done in 2012 by the Standing Committee on Natural Resources here in Parliament, “Current and Future State of Oil and Gas Pipelines and Refining Capacity in Canada”. It talked about there being at that time 19 refineries. I'm wondering how many refineries we have built in the last 25 years.

Mr. Peter Boag: The answer is none. The last new greenfield refinery built in Canada was built more than 25 years ago. We have a bitumen refinery being built today north of Edmonton that is considered a refinery, not an upgrader, because it will actually produce the finished products.

But the number of refineries is one side of the equation. The more important side of the equation really concerns combined and aggregate refinery capacity. Although we may have had more refineries 30 or 40 years ago in Canada, we've gone through a consolidation process to make our refineries more efficient and we actually have much more refinery capacity today with fewer refineries than we had years ago, because those refineries have been expanded. They're larger and they're much more efficient, to be able to compete in what is a highly competitive North American market. So actually, today Canada is well supplied from its existing refining base. We produce more than we consume. Canada is a net exporter of refined products.

Hon. Ron Cannan: What capacity are we running at right now?

Mr. Peter Boag: Our installed capacity, on a name plate basis, is about two million barrels a day, and Canadian demand is about 1.6 million barrels a day. So about 25% of Canadian refinery production is exported, largely to the United States.

Hon. Ron Cannan: As you chart out that surplus right now, is it trending outward? Will we continue to have a long-term oversupply?

Mr. Peter Boag: Certainly the supply situation in Canada is going to remain strong, because we are in a market that, in terms of the demand for refined products not only in Canada but in North America, is flat to declining. That is a function of our mature demographics, our very mature transportation systems, rapidly expanding vehicle fuel-efficiency requirements, as well as the increased market penetration of alternative fuels. The demand for refined petroleum products is actually flat to declining, if you look out over the long term in North America.

Hon. Ron Cannan: Would you support market diversification, then?

Mr. Peter Boag: Market diversification is certainly a potential opportunity, but the issue is whether you can be ultimately competitive. Can you actually access those markets, and then, can you be competitive in those markets while at the same time making an adequate return on investment? There's a lot of economic and commercial risk associated with opening up new export opportunities for finished products.

Hon. Ron Cannan: Thanks.

Mr. Reynish and Mr. Dunn, I'd appreciate your comments. Following up on Mr. Brison's comments about the Saudis' influence on the world pricing, *The Economist* magazine a few weeks ago talked about part two of the Saudis' initiative and how they're, some would say, dumping large quantities in the market and disturbing the world pricing. We saw a little correction back three weeks ago. There was some optimism going at $59, the high fifties. We're back down to the fifties today. From the world supply and what the Saudis are indicating, what's the rationale if OPEC is saying 400,000 barrels per day this year? Others think it could be even higher than that. Is that something you're modelling at? Is that 400,000 figure something that folks from your industry are looking at or is it a conservative estimate?

● (0955)

Mr. Steve Reynish: I'm not quite sure what the 400,000 number is but let me make a couple of comments. I think some of the analysis I've seen that does resonate with me is, first, I think we found out that for Saudi Arabia the last three or four years at $100 or $110 Brent and with very little volatility, if any, in the market did not work for them, if you like. It brought stability to a lot of the market around the world but it caused a lot of investment to go into the production side of oil and created the glut. That would be one comment that I think seems to resonate with us.

The Chair: Could you just briefly wrap up.

Mr. Steve Reynish: Yes.

The second one is that you read a lot of reports that they need, socially, a much higher price themselves. I guess we don't know what's in their minds and we don't know how it will play out, but I don't think we think this current price will stay forever.

The Chair: Thank you.

Thank you, Mr. Cannan.

[*Translation*]

Mr. Côté, you have five minutes.

Mr. Raymond Côté (Beauport—Limoilou, NDP): Thank you, Mr. Chair.

I would like to thank all the witnesses. Unfortunately, we don't have time to look at the question in depth, but I would like to thank you for being available.

I'll start with Mr. Boag.

In the Natural Resources Canada document, I see that the refinery margin is clearly higher to the west of the Ottawa River. We're talking about refineries in Toronto, Calgary and Vancouver, compared to those in the east. The Canadian Renewable Fuels Association's document provides an explanation and says that the situation was caused by excess refining capacity over demand.

Is that the only factor for explaining the clearly higher margin in the west than in the east? Are there any other factors?

[*English*]

Mr. Peter Boag: In fact, the most significant aspect on refining margins is actually the crude price differential, in that eastern Canadian refineries are still largely dependent on imported Brent benchmarked crude where western refineries have 100% access to a lower-priced WTI benchmark crude. That would be the most significant aspect of that refinery margin difference between east and west.

There are other competitive dynamics in terms of the market. The interior part of Canada in the west is a largely landlocked market. It has less access from foreign sources of supply. Eastern refineries compete in the Atlantic basin market for which there are many more alternatives to supply because much of that market is adjacent to tidewater and fuel now is a product that is traded internationally, no longer just on a North American basis. There are a number of factors but certainly crude price market differences would be the bulk.

[*Translation*]

Mr. Raymond Côté: I read the document for investors in Valero. I'm talking about the Ultramar refinery on the south shore of Quebec City. I saw a radical change in terms of supply. Everything is imported from countries outside North America, but processing is done using crude mainly from the United States. Things can change very quickly. That happened within a year and a half in Saint-Romuald, on the south short of Quebec City.

[*English*]

Mr. Peter Boag: First of all, I don't have shareholders. We're a not-for-profit association representing the interests of members. Certainly selection of a crude biorefiner is driven by a number of factors including quality, availability, price, and what the market demand for products is, because your product slate is in part influenced by the crude you refine. It is a very complex and dynamic situation for any refiner in terms of the day-to-day decisions on what crude they are going to refine. That will change over time. That will change seasonally. It will change over the years as crude markets change and the product market changes.

[*Translation*]

Mr. Raymond Côté: Thank you very much.

Mr. McMillan, the previous presentations have shown us that oil sands development in the west was a long-term investment, given that it is done over a very long period of time compared to shale oil development, for example in North Dakota. Certain factors have an impact on production. There's been a slowdown in production of the oil sands here in Canada.

Has the changing barrel price had a significant effect in terms of slowing down shale oil production in North Dakota?

Is the impact significantly increased by the fact that developing this type of oil in North Dakota is much riskier and more short term?

● (1000)

[*English*]

Mr. Tim McMillan: My knowledge regarding the reaction in North Dakota to the current price environment isn't as good as it is regarding the reaction in Canada. The Bakken oil field straddles the Canada-U.S. border. Part of it is in Saskatchewan and Manitoba, and the experience in Manitoba and Saskatchewan would be very similar to what's happening just south of that line. The reaction has been quite clear. Drilling numbers are down. In our January snapshot, we predicted about a 33% reduction in drilling in conventional oil production. Since that prediction we have seen that decline even further.

The same effect would be happening in North Dakota or in the Eagle Ford in Texas or across the U.S. As companies look to realign themselves to be successful in the long term, we are seeing them react.

[*Translation*]

The Chair: Thank you, Mr. Côté.

[*English*]

Mr. Van Kesteren, go ahead, please.

Mr. Dave Van Kesteren (Chatham-Kent—Essex, CPC): Thank you all for being here this morning. It has been an interesting discussion.

Mr. McGowan, I want to congratulate you on your points. Oftentimes when we have testimony, we get lost in a lot of the explanation, but you did a magnificent job of expressing your observations and your recommendations. I want to talk about some of those things, because there seems to be a suggestion that we can possibly work this in our favour.

Here's my problem. We don't have any economists, and I'm certainly not an economist either, but I do understand supply and demand. I'm also very nervous when governments.... I think of Ronald Regan and the famous quotation of “I'm here to help”.

What can we agree on? Is there a consensus in the industry that we should move some of the western petroleum, and would the refineries then do the needed updates so that would work? I'm looking for that marriage between supply and demand. Who decides? Suncor doesn't go to the government...at least not at this point, and I hope that day will never come. The market decides these things.

Is there a consensus? Is there something we recognize as industry and we can recognize as government that we can start to work towards? I suppose at this specific point I'm talking about the pipeline to the east.

Somebody mentioned something about the tides too. Are you talking about when the oil tankers come in? They float with the tides, don't they?

Mr. Peter Boag: I think the term we would use is access to tidewater, and tidewater means you have access to big ships that facilitate trade in market waters.

Mr. Dave Van Kesteren: Speaking of tidewaters, I understand when the oil tankers come in, they actually use the tides. They're that close when they get into Montreal. Is that not correct?

Mr. Peter Boag: I'm not an expert on that, so I would be hazarding a guess and I'm not going to do that.

Mr. Dave Van Kesteren: Okay.

Does anybody want to comment on that? I think I'd like to hear what Suncor has to say.

Mr. Steve Reynish: The comment I would make—and I hope I'm getting to your question here—on the question of pipes is that the key thing is to connect the resource with the market. That's what the pipes are for. I don't think it's about the labour involved in actually building the pipe, although there are real jobs. The real economic significance comes from connecting the resource to the market.

I think over the last number of decades Canada has had the resource, and the U.S. has been the big market. I think with the rapid increase in U.S. production, that dynamic has started to change. I think one of the big economic things going forward is how we can diversify that market. I think that's the whole point of the pipeline debate, if I can call it that.

● (1005)

Mr. Dave Van Kesteren: But again, we're talking about how "we" diversify. Are you suggesting it's the government's role to enter the market and to determine where these products should go and how much of that product should go there?

Mr. Steve Reynish: I would say it's a market solution, but I think it involves all of us—obviously industry, but I think government has a role in a lot of this as well.

The Chair: Mr. Van Kesteren, Mr. Dunn wants to comment as well.

Mr. Richard Dunn: Thanks. I appreciate that, Mr. Chairman.

You asked about what we can agree upon. I believe we can agree that oil and gas is an important industry to Canada from a national perspective, whether it's suppliers across the breadth of the country or governments that get revenues from oil and gas across the breadth of the country. I believe we can agree on that. I also believe we can agree that we're moving into a new era with respect to the need for competitiveness, and that, whether that's driven by the supply-demand dynamics in North America or by reduced prices, there is a compelling need, in order to achieve as much of the market access and growth in the investment in the industry as possible, to be as competitive as possible.

It takes actions by both industry and government to impact that.

The Chair: You're almost out of time.

Mr. Dave Van Kesteren: Maybe just quickly Mr. McMillan could answer that as well.

The Chair: Mr. McMillan, go ahead very briefly on that point.

Mr. Tim McMillan: I think it's a great question. When we talk about diversification, there are the LNG options off the coast. We have always thought LNG was a landlocked, North American phenomenon. We have 200 years' supply, as Mr. Dunn mentioned. There is a 60% growth expectation in Asia for natural gas. Canada can be very well positioned.

I think the federal government and provincial governments do have a role in enabling that. The announcement we saw on the tax treatment for LNG facilities, to treat them like all other facilities, is an important part of that.

The Chair: Thank you very much.

Mr. Adler, please.

Mr. Mark Adler (York Centre, CPC): Thank you, Chair.

Thank you all for being here today. Before I start my questioning, I want to make a comment.

Mr. McGowan, you mentioned that prices go up and prices go down. That's very astute, and that's how the marketplace works. I want to ask you this. Is the marketplace working as it should right now?

Mr. Tim McMillan: I think on a world basis, the commodities are traded freely. I think there are challenges in market access, which is a disadvantage to—

Mr. Mark Adler: We'll get to that, but is the marketplace working?

You know, we wouldn't be holding these hearings if the prices were $110 a barrel, but they've gone down. It has of course a multiplier effect. You're here because there's been a shift in prices.

So is the marketplace working as it should?

Mr. Tim McMillan: I grew up on a cattle ranch, and we saw the price of beef go up and down on a regular basis, as it does when a product is traded on a world market.

Mr. Mark Adler: Okay.

Right now, because of the shift in prices, would you recommend any change in the regulatory regime? What I mean by that is: should we as a government be doing anything that we're not doing, or should we stop doing what we are doing, to influence that price?

Mr. Tim McMillan: I think we are price-takers on a world market. As an industry, we hope our government has very robust and certain regulatory rules that are public so that we know how to operate in them and we can operate effectively in them. WorleyParsons has done a review that Canada has one of the best regulatory systems in the world. That's important for certainty for our industry.

Getting those fundamental pieces right is essential. Market access is one of the obvious ones that we view as a barrier to us being successful. At $100 a barrel, at $80 a barrel, at $50 a barrel, it's fundamental to get the basic pieces straight.

Mr. Mark Adler: With regard to the fact that we're right now experiencing a dip in the global price of oil, you wouldn't recommend any rash decisions being taken by any government or any regulatory regime to rush in to influence that price.

Mr. Tim McMillan: No, I wouldn't advise that.

Mr. Mark Adler: Okay. Thank you.

Mr. Dunn, right now about 15% of the oil that is exported is going through pipelines. I think we have the third-largest oil reserves in the world right now. That oil in the ground isn't doing anybody any good. Once we get it out, we need to ship it somewhere. At 15%, the pipeline infrastructure we have right now is not going to carry that capacity. We need more pipelines. Is that correct?

● (1010)

Mr. Richard Dunn: Yes, definitely, we need that export capacity in various ways, shapes, and forms to access different markets. We need more pipelines to access different markets.

Mr. Mark Adler: How fast would you say the oil trade is growing, not just here in Canada but around the world? Do we have a window of opportunity right now to do something about the export of oil that may not be working in our favour a few years from now?

Mr. Richard Dunn: I'll let Tim comment on the growth. I would certainly say that worldwide the markets are growing. The opportunity to access Asian markets with both oil and natural gas is significant, and without a doubt Canada has vast resources that it can draw upon.

Sorry, the other parts of your question...?

Mr. Mark Adler: Mr. McMillan, you were going to pick up on that.

Mr. Tim McMillan: Certainly. We see the world demand for energy growing every year by about 1%. For oil that's about a million barrels a day on an annual basis. Where we're seeing the growth isn't in our traditional markets; it's in Asia, it's in India, and it's in Africa.

Mr. Mark Adler: Is our current infrastructure well suited to...? We all know how important it is to diversify our markets. Are we in a position right now to do so, given our current situation and our lack of pipeline infrastructure?

Mr. Tim McMillan: Today's capacity does not allow us to access the growing markets in the world in the way that we think Canada should as a supplier of choice.

Mr. Mark Adler: Getting back to what you said at the beginning, that the energy industry is not just the energy industry anymore, this is a national sector and a national industry with tens of thousands of jobs, millions of jobs.

What kind of effect is that going to have on Canada's economy going forward if we don't do something about pipeline infrastructure now?

Mr. Tim McMillan: I think Canada has a great opportunity to be a world supplier. The effects of us reaching that potential will be felt and the benefits will be felt, not just across Canada but in the countries that are seeing their middle classes grow. People today who are cooking over an open fire may have access to natural gas from Canada a decade from now if we do things right. The types of decisions that you're talking about, as the policy leaders you are, will have great effects not just in our country but far beyond us.

The Chair: Thank you, and thank you, Mr. Adler.

There are a couple of minutes left. I have a number of questions, but I don't have time for all of them. I'll try to get one on the table.

I do agree that we should not overact both at the federal and provincial levels.

Mr. Reynish, you said Suncor was scheduled to pay $2.7 billion in taxes to the Canadian government and now it's done to $800 million. That is a sizeable impact. Another concern...Mr. Dunn, you raised the new normal. You've certainly faced a new normal in terms of natural gas prices. People talk about markets going up and down, but the concern here is that we have a fundamentally changed geopolitical situation, and a fundamentally changed crude production market, with the U.S. coming on in such a large way as being one of the top three crude oil producers in the world. You have the reaction by OPEC and by Saudi Arabia, presumably to distort the market and drive the price down, to preserve or increase their market share. That seems to me to be the big elephant in the room that we haven't yet addressed today, and I'm doing it with two minutes left in the panel. Is there someone who wants to take that on?

Canada is a price-taker in this whole thing. The concern is that if OPEC or Saudi Arabia keeps that up as a market strategy, how long can we in this country sustain that?

I'll look to Mr. Reynish. I probably only have time for one or two of you to comment on that.

Mr. Steve Reynish: Let me say I think yours was a very good summary of where we're at. We are planning at Suncor for a two-year horizon for these much lower prices. I think we do see that volatility is back in the market, and I think we'll see some big swings both up and down going forward.

● (1015)

The Chair: Mr. Dunn, do you want to comment on that?

Mr. Richard Dunn: Yes. I agree with your comments, Mr. Chair, around the new normal and getting to the new normal. We shouldn't overreact, nor should we ignore that there will be a new normal. Competitiveness will be critical in terms of how Canada fares in the new normal. There is an urgency to continued action on all of our parts.

The Chair: Thank you. I appreciate that. I'd like to get into that more. Maybe Professor Leach can address that in the next panel.

I do want to thank all of you so much for being with us. If there's anything further you want the committee to refer to, please submit it to me. I'll ensure that all members get it.

I want to thank all of our witnesses here in Ottawa.

Mr. McGowan, thank you so much for getting up two hours earlier in Edmonton to be with us from there.

Colleagues, we'll suspend for a couple of minutes and come back with our next panel.

● (1015)

(Pause)

● (1020)

The Chair: Colleagues, please find your seats for the second panel. We will begin right away. Thank you.

We're resuming our discussion here, continuing with our study of the impact of low oil prices on the Canadian economy. This is our second panel here this morning. We have four witnesses to hear from for this panel.

First of all, from the University of Alberta, we have Professor Andrew Leach from the Alberta School of Business. Welcome, Professor Leach. We have from the Canadian Renewable Fuels Association, the president, Ms. Andrea Kent. Welcome to the committee. From Packers Plus Energy Services, we have Mr. David McLellan, senior economist and business strategist. Finally, from TransAlta Corporation, we have Mr. Rob Schaefer, executive vice-president, trading and marketing.

We will begin with Professor Leach. You each have five minutes for your opening statements and then we'll have questions from members.

Dr. Andrew Leach (Associate Professor, Alberta School of Business, University of Alberta, As an Individual): Good morning. Thank you very much. It's a pleasure to be here with you today.

● (1025)

I'd like to deliver remarks on three aspects of the oil price crash for you today. First, I'll look at how the changes of the market have affected the outlook for oil sands projects. Second, I'll talk briefly about greenhouse gas policies and oil sands projects in light of the oil price crash. Then, if time allows, I'll add something on refining and upgrading as well.

As you know and as we discussed in the first panel, oil prices have declined considerably over the past nine months. Early on we had a little bit of an advantage in Canada, in particular for oil sands, with a weaker Canadian dollar, lower discounts, and cheaper diluent, which led to Canadian oil sands projects probably faring better than projects did on average globally. That's actually reversed now, so things have gotten a lot worse in the last little while for oil sands. It seems every time I write that they're okay, they get worse.

To understand the impacts of these prices on oil sands projects, I will go quickly through three aspects.

When you look at CAPP's oil sands production forecast, we think that's a reasonable benchmark for what industry has planned. You see about two million barrels a day of current production, about another one million barrels a day of production that we're expecting to come online, which is currently in construction, and then another two million barrels per day of forecasted growth projects. These would be projects that don't have significant capital already invested in them.

If you divide the existing operations into those three groups, you're at very little risk of seeing any of those shut down. To take a couple of simple examples, for a project like CNRL's Horizon, you're looking at a cost of production of about $38 per barrel today for a product that sells for about $60 a barrel. So you still have a healthy operating margin.

Suncor, from whom you heard earlier this morning, has pretty similar statistics. Their production costs—and they're in the high end of the oil sands producers, because they have a large integrated project—per barrel are about $35, and that barrel sells for about $60 to $70. If you go down through their existing in situ projects, they're at very little risk of actually shutting any of them down unless the oil prices get a lot worse.

New projects are a little bit of a different story. Like economists, we always have two hands, so I'll talk about two types. On the one hand, we have the projects for which significant capital has already been invested, and on the other hand we have the projects for which it hasn't been.

If you look at the ones with significant capital investment—and we saw a good example of this recently, again from Suncor, with the Fort Hills project—even though that's a relatively expensive project, it was worthwhile for them to continue that because the forward-looking view, even with lower oil prices, is still for a positive rate of return on investment.

This is also an area in which you can plainly see the impact of the Canadian dollar. We used to think of new mines as being projects for which you needed $85 to $100 WTI to make work. With today's Canadian dollar, you can probably make a new mine work somewhere between $65 and $70 WTI, if the Canadian dollar holds where it is right now. For a new in situ project, those numbers get even lower, down into the $50 to $65 a barrel range. If we're looking at the projects that are currently under development in which significant capital has been invested, those numbers get even lower still.

So what does that mean in terms of what you should expect? It means you should basically expect what you heard Mr. McMillan from CAPP talk about this morning—a pullback in future capital investment on new projects leading to a decrease in the rate of increase in oil production, if you can follow that double negative. So there will be less production than what you expected but more production than you have today.

Second, could a GHG policy disrupt this trend? Would it be crazy to introduce new policies on oil sands emissions?

I don't think so. If you look at the types of policies that have been proposed, whether for something like a 30-30 or 40-40 approach in Alberta or at the federal level, or even something like B.C.'s carbon tax, the margin you're talking about is, for a 30-30 approach, maybe 10¢ to 25¢ a barrel. If you take a B.C. carbon tax approach, it's maybe $1 per barrel at most.

I don' t know about you in this room, but I actually find it far less comforting to think of the fact that our oil sands industry is 25¢ a barrel away from disaster than I do to think of the prospects of a greenhouse gas policy. I think we're much better off if we have a credible greenhouse gas policy in the oil sands than we are if we have none at all.

Lastly, on refining—and you heard some thoughts on refining from Mr. McGowan this morning—it is true that refining margins hold up better, because they tend to reflect the cost of refining, and they don't tend to reflect the cost of crude. We're finding that margins have been more stable, but according to recent analysis that I've just pulled together over the last couple of weeks, the total return to shareholders, to governments, and to royalties would be higher by a factor of about 40% for extraction alone versus extraction plus refining per dollar invested.

Thank you very much for your attention. I look forward to your questions.

The Chair: Thank you very much, Mr. Leach.

Ms. Kent, please.

Ms. Andrea Kent (President, Canadian Renewable Fuels Association): Good morning. Thank you very much.

It's a privilege to be here today on behalf of the Canadian Renewable Fuels Association and our membership.

Just by way of a quick background, our domestic biofuels industry is now generating $3.5 billion yearly in economic activity. We've created over 14,000 quality Canadian jobs to date. We return over $3.7 billion in investments back to the government every year. We've had significant growth since 2006.

Notably, 26 renewable fuel plants are operating across Canada. They make more than just biofuel. We make clean technology. We're making new products, and we're expanding our renewable fuels supply.

CRFA represents the full spectrum of Canada's domestic biofuels industry. Our members are biofuel producers, petroleum distributors, retailers, and farmers. Over our 30-year history, we've seen many challenges and we've risen to them. Declines like this and these low prices that we're seeing in this environment certainly are not uncharted territory. Of course, this is not to minimize the impact that lower oil prices have on our industry or our membership, but it is not uncharted territory. We've been here before.

After all, renewable fuels and petroleum industries are very closely linked and tied. Earlier in this hour, we heard from CAPP and from CFA. I want you to know that those two groups really encompass our customers. They are our members as well—you heard from Suncor. We work together, we play direct roles in one another's successes, and by that token, what affects one impacts the other.

With the committee's questions in mind, I will give you an overview of what we're seeing in our industry as a result of lower prices.

By way of context, we have federal mandates. There is a 5% requirement for ethanol in the gasoline pool and 2% for biodiesel or renewable diesel in the distillate pool. It really is important to note that those mandates and that stable policy is helping us offset a lot of the disturbances that a low price environment can create.

While we are a domestic industry here, a lot of our business actually operates on a north-south trade axis. American ethanol imports have been slashed. Their exports to Canada are significantly lower than last year's projections. With those U.S. exports drying up, the product does back up into the American market. It has caused depreciation in the U.S. market.

It's reducing the amount of overblending in the Canadian market compared with what we have seen in previous years. It's significant because with overblending and over-compliance largely due to the price advantage of ethanol, Canada overblends and exceeds the national mandate requirement by about 130% a year. This is going to dry up now because that price advantage for ethanol is shrinking.

On average, the wholesale price of ethanol has been roughly 20¢ cheaper than gasoline. Falling gasoline prices weaken that price advantage and essentially remove a lot of the financial incentives for higher blends and for overblending that we've seen in the past.

The resulting glut of product in the U.S. also shrinks the market for Canadian biofuels, so it reduces demand and it puts downward pressure on profit margins. At the same time, we see input costs that are a bit higher, purchases that are down, investors who see their portfolios shrinking, and access to capital tightening. In one way or another, we all feel the effects.

Even more concerning than price fluctuations in the short term is policy instability in the medium and long term, and that's true in any market. The long-term need for Canada to diversify its fuel mix really does remain strong. That's kind of the point here for us and our members today and that is in the face of anything, including declining oil prices.

The good news, and there is good news, is that Canada benefits from stable national mandates that have helped build resiliency. However, if we are to continue to grow and progress, government policies need to keep pace by: specifically, renewing and expanding renewable diesel mandates, which is important, moving from 2% to 5%; and supporting innovation and developing broader market access for producers. That's going to echo a lot of the comments that you heard in the first hour.

Thank you very much for the invitation. I look forward to your questions.

● (1030)

The Chair: Thank you very much, Ms. Kent.

We'll go to Mr. Schaefer and then to Mr. McLellan.

Mr. Rob Schaefer (Executive Vice-President, Trading and Marketing, TransAlta Corporation): Thank you and good morning. My name's Rob Schaefer and I'm the executive vice-president of trading and marketing at TransAlta.

Thanks for having me here today. I really appreciate the opportunity to speak here about the impact on the electricity sector of declining oil prices.

Before I get started just let me introduce TransAlta for those of you who aren't familiar with us. We are Canada's largest, publicly traded power generator and marketer. We've been in business, headquartered in Calgary, for over 100 years. We are a well-diversified company. We have operations across Canada, in the United States, and in Western Australia. We have 64 generation facilities and we span pretty much all fuel types, from hydro to wind to coal to gas, with a total fleet capacity of over 8,500 megawatts across all those jurisdictions. We're Canada's largest wind generator and we're among the largest publicly traded renewables companies in Canada.

We're in your communities. We have small hydro facilities in British Columbia. We have efficient coal plants in Alberta. We have wind farms in Quebec. In fact, we have a gas cogeneration plant right here in Ottawa serving the children's health centre just north of here. We've been serving that facility for a number of years and we're very proud to have just worked out a new deal with the Ontario Power Authority to continue the operation of that plant.

We're very involved in the oil and gas sector. Of course, we supply power to the grid in Alberta. We supply all oil and gas producers that way. We also have cogeneration facilities right on site with Suncor, for example. We just heard from Suncor earlier. In fact, we've been in business, in partnership, with Suncor at Fort McMurray for 14 years, with a cogeneration plant there. We serve their refinery in Sarnia, Ontario, as well. Clearly the oil and gas sector is important to our business.

What I would like to do here today is to speak to the impact of oil prices on the power sector, and I'm going to cover both the short-term impacts as well as the long-term impacts.

Thinking about the short term, what we're seeing today are the lowest power prices we've seen in years in Alberta, and actually across North America. There are a couple of things going on here.

Number one, we've had a significant amount of new power supply come in during the last couple of years, brought on by having relatively higher prices that brought on new supply. Now we're seeing the impact of that with quite low prices.

The second thing, though, is that we have very low natural gas prices. I think you heard about that and you've certainly been aware of that. So what's happening is that we're seeing a trend of increased competition between gas and coal in Alberta and in other markets as well. In fact, in 2014 coal ran about 12% less than what it was capable of, and our analysts are linking that to low gas prices. Basically in any jurisdiction where you have a reasonable amount of gas-fired generation you're seeing the impact of that on the markets. Those are the short-term impacts.

The longer term impact is this. As difficult as low oil prices are on the oil sector, it's also difficult on the power sector. If we see a protracted period of low prices, it's going to be difficult to make the investments we require to renew the generation fleet across Canada. Clearly in the short term consumers are better off with low power prices. The challenge is that, longer term, we could see a knock-on impact in the form of higher prices later, and even potentially supply shortfalls. You know that in western Canada, in particular, an oil and gas industry that's not investing in growing means a flat load growth for the power sector.

● (1035)

As we look to the 2020 timeframe to renew our fleet, if we have a protracted period of low prices it's going to be challenging to do that, no matter what fuel technology you want to talk about because all new generation comes with large price tags. There is a long lead time to make those investments, much longer than the oil and gas sectors themselves, so you get into a timing crunch.

That's the bottom line. Just to wrap up, at TransAlta we're certainly up for the challenge. We've adapted to the effectively low mining revenues in Western Australia, the manufacturing sector in Ontario. We've been dealing with the growth we've had in western Canada. We can certainly deal with a softer market. It's not the first time we've seen it; it won't be the last. We're certainly up for the challenge.

Thank you very much, and I welcome your questions.

The Chair: Thank you for your presentation.

We'll go to Mr. McLellan, please.

Mr. David McLellan (Senior Economist and Business Strategist, Packers Plus Energy Services): Thank you.

Packers Plus Energy Services is an excellent case study on innovation and success originating in the Canadian oil patch. I'm honoured to have been afforded the opportunity to participate in today's panel discussion on the impact of the decline of global oil prices on the energy sector and the Canadian economy.

Our company was founded in Calgary at the turn of the millennium by three partners. They developed a system that allowed for the efficient extraction of hydrocarbons from tight formations through hydraulic fracturing. Its introduction was a catalyst for radical change in the industry as it combined with advances in horizontal drilling such that North American hydrocarbon production has grown considerably faster than North American demand. The consequences of this are not unrelated to why we are convening today.

Today Packers Plus has almost 1,000 employees with 32 locations around the world. Our company designs, manufactures, sells, and installs the highest-quality completion systems in the industry. We've now become the fourth largest completion company in the world after behemoths such as Schlumberger, the new Haliburton-Baker Hughes merged company, and Weatherford.

Ours is an example of how Canadian innovation and oil field expertise is sought and exported around the world.

If we discuss impact on prices, first I would like to point out that the members should consider that a barrel of oil is not necessarily homogeneous. There are varying crude qualities coming from different locations to a number of destinations. Canadians will be most impacted by the price of West Texas Intermediate and the Western Canadian Select blends.

Standard pricing is in U.S. dollars and it facilitates easier comparison and international trade. This means there is an inverse correlation between oil prices, particularly WTI, and the U.S. dollar. The current strength in the U.S. dollar is one aspect hampering a recovery in oil prices. Note that many OPEC and other oil-exporting nations have increased demand for U.S. dollars because they need to fund their budget shortfalls with their sovereign wealth funds and foreign currency holdings, and by holding U.S. dollars it protects them against currency losses.

Of course, Canadian producers have benefited by that in that the Canadian exchange rate has dropped from about $1.07 per U.S. dollar to close to $1.21 today.

Brent crude is the international blend and it's what sales are frequently based on. Over the last 25 years West Texas Intermediate has averaged a slight premium of about 2.6% over Brent, but since 2009 and the introduction of new hydraulic fracturing technologies, WTI has traded primarily at a discount. The discount has been relatively volatile but has more recently averaged over 20%. This premium represents lost opportunity for the Canadian economy and should be part of recognizing the motivation to increase our market access to tidewater so that we can sell into that market.

Despite the contention of my colleagues on the previous panel, oil is not necessarily the global commodity it's made out to be. The United States right now has a law banning export, so we have a North American market. Shale oil in the U.S. has increased production by four million barrels a day at a time U.S. demand has fallen from a 2006 peak of 22 million barrels a day to about 19 million barrels a day today.

With respect to the reduction in E and P capital expenditures and reduced oil field activities that was talked about, we are seeing sharp drops in North American rig counts. According to the CAODC website, each rig represents about 20 direct jobs and 135 indirect jobs. The rig count has dropped from over 1,800 in November to about 1,500 now, and it is expected to bottom later this year at perhaps as low as 1,250. A price recovery above $70 U.S. for West Texas would provide the signal to start adding rigs and subsequently increase production.

In the service industry that we are part of we've seen the reduced capex budgets and drilling activity felt across our industry. Competitors such as TriCan have experienced layoffs and have asked their staff to take pay cuts. Operators have been asking for and receiving price cuts but there are limits to how much of the price burden the service industry can or is willing to take.

This new reality will renew focus on efficiencies and provide incentives for companies to adopt more innovative approaches. A $90 West Texas Intermediate environment produced a pattern of drill, complete, put on production, and repeat among many shale operators. They became so busy ramping up their production they really didn't focus on efficiencies. This reduced activity level has now given them an opportunity to pause and review data.

● (1040)

Subsequently, we at Packers Plus expect first to see a lot of high-quality research papers produced, and then to gain some significant market share for us.

I am based in Houston, Texas, after 16 years in Calgary. Half of our business comes from Canada. We are looking to grow significantly in the United States. Open hole completions are the dominant completion method for unconventional ex-oil sands in Canada but in the U.S. it's cemented liner plug-and-perf.

The Chair: Could we get you to conclude, please?

Mr. David McLellan: Wrap it up?

The Chair: Yes, wrap it up very quickly.

Mr. David McLellan: Sure.

How about this? I look forward to your questions.

The Chair: I will have questions for you. Thank you very much for your presentation.

Colleagues, I think we're going to try six-minute rounds to be fair to all the members.

[*Translation*]

We will start with Mr. Dionne Labelle. You have six minutes.

Mr. Pierre Dionne Labelle: Thank you, Mr. Chair.

My first question is for Dr. Leach.

You said that the equilibrium cost of past projects was $75 a barrel and that the equilibrium cost of new projects was $50 a barrel. Say the barrel price remains at $50 for the next five years. In fact, from a global geopolitical perspective, the trend is that there is an oversupply. What would be the impact of sustaining this price on Canada's oil industry, specifically on projects with an equilibrium cost of $75 a barrel?

Dr. Andrew Leach: That's a good question.

[*English*]

If you did see a sustained oil price world in today's price.... All the numbers that I gave you were based on holding today's prices as predicted by the futures market right now. If you did see that hold, what you are going to see is that most projects under construction will go to completion. Most if not all existing projects will stay in operation on the oil sands side. Probably some of the top-tier new projects and expansions will go forward, but you'll probably see a larger share of the expected two million barrels a day delayed or cancelled.

On the light oil side, it's a little bit of a different ball game in that those are very quick to ramp up and ramp down so you'll likely see more. My colleague, Mr. McLellan, could probably comment more on that, but you'll see much more variability in those spaces. They do make money at a lower oil price often but they're also more easily brought online or off-line. So you may see more rapid delays in those sectors.

[*Translation*]

Mr. Pierre Dionne Labelle: Today, we heard from an economist with the Alberta Federation of Labour. Several people have spoken about the need to export oil to international markets. The economist in question said that if we export oil to international markets, given the current oversupply, we would increase the supply, would help keep prices low and would encourage the non-profitability of oil sands development.

Do you see the logic in that?

Dr. Andrew Leach: Again, we need to keep in mind the following.

[*English*]

What we need to keep in mind is that, yes, there is an excess of supply in the world markets. That's what's pushing the price down, but that factor is even more prevalent in the North American market, as Mr. McLellan also mentioned. We have a landlocked market in North America, which is leading to prices here being lower than they are on world markets.

So, no, by exporting Alberta bitumen to world markets, you're not going to see us getting a Brent price for Alberta bitumen. But you also would be talking about a relatively small quantity in the global scheme of things, if we're talking about increasing exports off the Canadian shores by, let's say, a million barrels a day.

● (1045)

[*Translation*]

Mr. Pierre Dionne Labelle: This won't make the barrels that are produced more profitable.

[*English*]

Dr. Andrew Leach: It will make them marginally better relative to what they would be otherwise. You're not going to get back to a hundred-dollar-a-barrel world or anything magically, but you're also not going to have a big impact on global markets. We're just not big enough to move them.

[*Translation*]

Mr. Pierre Dionne Labelle: You mentioned the issue of the greenhouse gas emissions policy. Can you expand on your position on that?

Dr. Andrew Leach: Certainly.

[*English*]

I don't have a specific policy that I'm advocating for, for example. My position generally is that what we should have in Canada is a policy where we can look at our policy and say that if everybody else implemented this policy, we'd reach an agreed-upon set of global goals.

So if that's the two degrees Celsius goal, we should be able to go to credible researchers, tell them to take the policies we would implement in Canada and impose them globally on other economies in the same way, and see what would happen globally. If we don't meet global goals, then by my definition, we're not doing our share. I wouldn't get into global pie-dividing by asking what percentage of historical emissions do we get, or they get, or what have you. I'd look more at the policies themselves.

[*Translation*]

Mr. Pierre Dionne Labelle: If I understand correctly, you think that we aren't sufficiently involved in this area. That's what I got from your comments.

[*English*]

Dr. Andrew Leach: I think we have some very interesting policies, both provincially and federally, that we can build on. I think if you took my test, which is to take Canada's policies and impose them globally, you don't have enough stringency to meet the global goals that Canada's governments agreed to at Copenhagen, for example.

[*Translation*]

Mr. Pierre Dionne Labelle: Ms. Kent, was it you or Mr. Schaefer who spoke about wind farms? I think it was Mr. Schaefer. Well, my question is for both of you.

What is the future of wind farms? We know that there has been a lot of criticism, opinions I don't necessarily share. What do you see for the future of wind energy in Canada?

[*English*]

The Chair: Ms. Kent.

Ms. Andrea Kent: We deal with the liquid transportation field, so I think that Mr. Schaefer would be better placed—

The Chair: Okay.

Mr. Schaefer, please.

Mr. Rob Schaefer: On the future for wind, certainly the wind generation that's in place today will continue to be in place. We have wind across Canada and it's working quite well.

The challenge I'm pointing to is that if we see a protracted period of low prices, any form of generation is difficult to make an investment decision on. Wind is one of the more expensive forms, so it becomes a challenge to continue to grow the wind industry.

Again, we're in a commodity cycle, so it won't last forever. My hope is that we'll be able to have the lead time that we need as an industry to respond to the demands of consumers in a reasonable way.

[*Translation*]

Mr. Pierre Dionne Labelle: Have you postponed any projects to date?

[*English*]

The Chair: A brief response, please.

Mr. Rob Schaefer: No, we haven't.

The Chair: Thank you.

Mr. Saxton, please, you have six minutes.

Mr. Andrew Saxton: Thank you, Chair.

Thanks to our witnesses for being here today.

My first question is for Andrew Leach from the University of Alberta.

Andrew, this is not the first time we have seen an oil price correction in Canada and across the world. How is this time different? How can we learn from past experience? How did past corrections impact the Canadian economy, and how will things be different this time, if anything?

Dr. Andrew Leach: That's a great question.

Probably the key difference from the most recent oil price crash, if we look at 2008-09, is that this is not a global economic crisis. This doesn't have the overriding credit constraints that we had in 2008-09, so that changes the dynamic of it. This is more of an oil supply shock, although, as we all know, there are some significant headwinds in the economy globally as well.

From a government and from an industry point of view, one of the key features—and I've written a bit about this crash versus 2008-09 in *Maclean's*—is that we didn't have a run-up in prices beforehand. We didn't have this buffering, of whether it's government budgets or industry balance sheets, that came from an unexpected price appreciation, as we had in 2007-08. That translated through to a crash and then you ended up averaging out much better than you would have had you just had that drop. This is a bigger drop against, for example, last year's prices. I think that is a key difference.

In terms of the supply side, you may have to look back to the eighties and nineties to get a better sense of what a global crude glut looks like and how long that can last. Whether we're in that or not, it is going to take a while to tell.

● (1050)

Mr. Andrew Saxton: Thank you.

My next question is for Andrea Kent from the Canadian Renewable Fuels Association.

Andrea, can you expand on how this oil price correction is affecting your industry?

Ms. Andrea Kent: There are a few things that are important to bear in mind.

This is related for us with fuel prices and the relationship between how gasoline is affected by that compared to the pricing for ethanol. Ethanol historically, on average, is about 20¢ cheaper per litre than gasoline. That results in a natural financial incentive for people to blend more ethanol into the fuel supply. That's not a bad thing because that cost saving is traditionally passed down to consumers. There is also a very strong GHG emissions reduction benefit that is associated with the higher octane in ethanol. On the whole, we see overblending in Canada and we surpassed the federal mandate. That's good news for producers because it's a good demand for their product.

When we see that this price advantage starts to contract there is less demand for ethanol generally because Canada also imports ethanol for this overblending from the U.S. When that demand in the U.S. market, which is much larger, starts to shrink then we see that product back up into the U.S. market. This means that the Canadian market for ethanol shrinks as a result. Ethanol is priced on the Chicago Board of Trade, so it attracts U.S. prices. Looking at the corn-to-ethanol price relationship right now, we have corn at CBOT, I believe, at about $3.50. It's still a profitable relationship, but it's nowhere near where we were this time last year in terms of profitability. When you look at 2014 it was a record-breaking year, so the numbers are going to be exacerbated a bit. It's going to look much worse, but that is because of the record profits that were recorded against North America as well.

One thing that's really helping, and I'll mention it quickly, is diversity. When we look at ethanol it's one output. DDGs, or dried distillers grains, are part of the feed market that comes off ethanol production naturally. The DDG values are good right now. That has buffered a lot of the price constraints and the operating costs that would otherwise be much more volatile in this environment for ethanol producers. I think that's a microexample of why diversity is good. If you look at biorefineries that are able to produce more products, they're going to have more market opportunities. That's going to help build that resiliency in the face of price fluctuations.

Mr. Andrew Saxton: Thank you very much.

My next question is for David McLellan from the Packers Plus Energy Services.

David, in your presentation you talked about the discount for Canadian oil because we only have one purchaser for our exported oil. How would the diversification of our markets for oil impact and benefit the Canadian industry, and how important are pipelines in this equation?

Mr. David McLellan: I think the answer is in the price differential between Brent and West Texas Intermediate. Our blends are based on a discount to WTI right now. If we were able to get material volumes to the coast it would be based off the discount to Brent. I believe that Canada, being a much more stable jurisdiction and seen very favourably around the world, would be a preferred supplier. I think that we could command a higher price as long as Brent trades at a premium to West Texas Intermediate. That is the situation, but nothing lasts forever. It would give us flexibility. What we need in industry is the flexibility.

Mr. Andrew Saxton: How important is it for us to diversify our markets?

Mr. David McLellan: I think it's absolutely critical. I'm now down in the United States in their oil capital.

Witnessing the president talk about Canada's extraordinarily dirty oil extraction is offensive. I've been to the oil fields of California. I've been to Malaysia, Indonesia, Algeria, and parts of the Middle East, and Canada does it better than everybody else. We have the president of our only customer saying it's extraordinarily dirty, disparaging it, and postponing Keystone. It's imperative that we see that not just as a signal, but almost a command to diversify our market.

● (1055)

The Chair: Thank you, Mr. Saxton.

[*Translation*]

Mr. Dubourg, you have six minutes.

Mr. Emmanuel Dubourg (Bourassa, Lib.): Thank you, Mr. Chair.

Good morning to all my colleagues.

Ladies and gentlemen, welcome to this committee meeting.

My first question is for Mr. Schaefer, who said that he is in a very diversified industry. He also spoke about the short-term impact of the drop in oil prices. He said that, in the long term, we will have difficulty renewing investments in this sector.

Given that his industry is so diversified, could he tell us about the impact of the drop in oil prices on employment in Canada?

Mr. Rob Schaefer Yes, gladly.

[*English*]

Thank you. That's a very good question.

My perspective is that I don't see the kinds of impacts we've seen in the oil and gas sector in the power sector. In other words, we're not seeing significant layoffs, or anything like that, because the generation that's in place will be needed and will continue to supply consumers for some time to come.

The issue is more about growth, or about replacement of generation, and it's a longer-term impact. I don't see dramatic impacts on employment. It relates more to how we invest and turn over the capital stock that we have today.

[*Translation*]

Mr. Emmanuel Dubourg: Thank you.

My next question is for Dr. Leach.

You said in your presentation that we don't necessarily need new legislation. I would like to know whether a policy on the price of oil might include economic benefits.

Dr. Andrew Leach: Could you expand a little on the type of policy you have in mind?

Mr. Emmanuel Dubourg: I'm not thinking of anything specific, but I would like to know whether there would be economic advantages for Canada and how that might affect a particular industry.

For example, do you think a company like Energy East could stabilize the price of oil in Canada?

[*English*]

Dr. Andrew Leach: Okay, thank you.

A project like the energy east pipeline won't have a stabilizing effect on world oil prices in the sense that it is merely moving product from one area to another. As some of the colleagues have already mentioned, a project like energy east would change crude movements in Canada. It would allow eastern Canadian markets to access western Canadian crude, but they will also be doing that at a cost. They're going to be paying a toll to move that oil across the country.

So what would you see? You might see a slight reduction in crude costs to eastern Canadian refineries. You might see a slight increase in the net revenues to western Canadian producers. But you have a long distance to cover, and that's important.

Why have we always, historically, shipped our oil to the centre of the U.S.? We shipped it to the centre of the U.S. because that was a premium market and because it was cheap to get it there. Even if you were a self-interested Maritimer saying, “I want cheap crude”, your best trade for decades would have been to take crude from Alberta to Chicago and sell it in Chicago, and then go to Saint John and buy oil at the port. That has changed a little bit now but it's not a free lunch, so to speak.

[*Translation*]

Mr. Emmanuel Dubourg: We have seen the impact that this price drop could have on the economy. In some ways, the economy is somewhat vulnerable.

Are we right to be focusing on a single sector of the economy?

[*English*]

Dr. Andrew Leach: I'd take issue with that. I don't think we have an economy that's any where near as focused on oil or on oil sands as your question might suggest.

Oil and gas is an important share of our economy, but it's far less than 10%. What we have seen is a lot of economic activity tied to the construction of new oil sands projects, and that may trail off a little bit. But if you look at it's share of our economy overall, we're not by any means a one industry economy. We're nowhere near as dependent on that oil and gas production as some recent sound bites have certainly led us to believe. We don't have all our eggs in one basket.

[*Translation*]

Mr. Emmanuel Dubourg: Lastly, to boost this sector in particular, should we try to improve relations between the Government of Canada and certain partners? I'm thinking here about President Obama's decision, so with the United States and with First Nations.

Do you think we should do more to facilitate relations between Canada and these partners?

● (1100)

[*English*]

Dr. Andrew Leach: I think, without question, with regard to both of the points you made, we need to look at what our position is globally, and in partial response to Mr. McLellan's point, how our resources are portrayed globally. There is that idea of communication, but it's also a question of what policies we put around our resources, how we portray those policies, and how we make it clear that we're operating under conditions that are globally credible.

On the first nations file, I couldn't agree with you more. I think we desperately need better relations on that file. I was shocked a couple of weeks ago. I read a survey—I believe it was in *Alberta Oil* magazine—of oil industry executives on what the barriers were to oil development. One of the categories offered was first nations. If I'm not mistaken, the answer was that 0% of respondents felt that first nations relations were a key barrier. That's something I couldn't disagree with more. I think, for a lot of our development in Canada, we could benefit a great deal from better first nations relations.

[*Translation*]

The Chair: Thank you.

[*English*]

We'll go to Ms. Bateman, please, for six minutes.

[*Translation*]

Ms. Joyce Bateman: Thank you, Mr. Chair.

I would like to thank all our witnesses for their testimonies. We have had good discussions with both panels.

[*English*]

Hopefully I will get to all of you because I so appreciate the discussion we're having, but I would like to start with Mr. Schaefer.

In your testimony—kindred spirits, another CA—you talked about the long-term impacts and the short-term impacts. The part I would like you to expand on a little more is the impact upon making investments in the industry. Obviously, if we don't feed the industry with investments, that's a factor.

Could you expand on that?

Mr. Rob Schaefer: Sure. Let me explain it a little in this way. It takes about five years to develop and build a power plant. It's much longer, if it's a hydro plant; that could take up to 10 years or more. It's a long cycle.

Like any industry, we respond to price signals. We have a low price signal right now. Nobody is going to invest, or it's going to be very difficult to make investments in that context. The challenge I'm pointing to is simply that if we have a protracted low price period and then get started with new investments, there is potentially a gap. This doesn't mean we won't make the investment; it just means that we're going to be challenged for a while.

Ms. Joyce Bateman: Okay. That's fair enough.

You've all spoken, as did our previous panel, about market volatility and the impacts of the market price.

Ms. Kent, you talked about that. It wasn't that long ago that we were reading articles about the negative impacts on Mexican farmers and the food supply chain, based on your industry growth. It has impacted upon all of us.

But Mr. McLellan, you're a relatively small player in a world market. We've had some big players come to speak to us on this issue. What are the particular challenges that you as a smaller corporate entity face, and what are the opportunities?

Mr. David McLellan: Our business is going to thrive and survive with the capital expenditures of the large E and P producers. If they're cutting, then we're just going to have less work.

The opportunity, though, is in market share. As my opening statement said, our completion technology was innovative. In fact, it was one of the key attributes to usher in this era of collapsing natural gas prices and now faltering oil prices, being able to unlock hydrocarbons from what had been previously uneconomic sources—shale oils, tight gas.

Our opportunity, then, is that, first, shale resources exist all around the world. We need to abandon all talk of peak oil, in the sense that we're not going to run out. We're going to move beyond the era of oil long before we ever run out. It is employing technologies such as ours that will enable the extraction of what had previously been stranded. Ours is a low-cost, efficient method developed in Canada.

There's some resistance in the United States. There's an attitude in Texas in particular that “if it wasn't invented here, it might as well not exist”. They can do that. They didn't face the same price pressures as Canadian producers. They are in the world's largest consuming market and are very close to the largest refining market. They didn't have the same regulatory oversight, and they don't pay their people the same. Canadian producers have had their hands tied behind their backs and have managed to thrive despite that by being more innovative.

Now with this new price regime, I'm finding that Texas operators are much more willing to sit down and ignore the fact that this is a Canuck technology. To be clear, I presented this. We're a global company. We are Canadian and proud to be Canadian, but we're now a global entity, and it makes it easier for the Texans if I present it that way.

● (1105)

The Chair: You have one minute.

Ms. Joyce Bateman: One minute?

Perhaps we could split the time between Mr. McLellan and Mr. Leach. You have touched already on the importance of the diversity of our market. I very much appreciate your comments on how Canada stacks up in terms of oil production in the world. Could you speak to how we diversify?

The Chair: Let's do a brief response from each, please.

Mr. David McLellan: Tidewater.

Ms. Joyce Bateman: Okay, that's pretty brief.

The Chair: Thank you.

Mr. Leach.

Dr. Andrew Leach: Highest value markets, absolutely. Today, that's tidewater, but don't lose focus on why we have the market we have. It was because we turned down going to tidewater to go to the mid-continent of the U.S.

The Chair: Okay, thank you.

We'll go to Mr. Cullen, please, for his round.

Mr. Nathan Cullen: Thanks, Chair.

Thank you for this. I find this a fascinating topic in general. We're trying to get a proper understanding of current prices and potentially prices that may prolong. There's been some talk today equally about uncertainty or volatility. It's somewhat volatile, but it's also been this way for a few months now, and most of the energy projections we read about at least say it's not changing tomorrow. The question I'm facing is not so much volatility, but a $50 price, just a lower price. Am I wildly outside of the parameters there, Mr. Leach, just in terms of some assumptions we're making about the federal budget, about the state of the energy economy in Canada?

Dr. Andrew Leach: No, I don't think so. I think you asked the question earlier about whether using the spot price as a forward-looking variable is a good one. I tend to be more of a fan of looking at the forward curve. That gives you a little more sense of how the market is betting. But the Bank of Canada had a research report last spring that indicated that the spot price was the best performing forecast over time, so assume that today's price plus inflation....

Mr. Nathan Cullen: The Bank of Canada said that last spring. The federal finance department said that last November. In the fall update that they used for Canada's economy they chose the spot price as the assumptive. That's a small “c” conservative approach. Is that a prudent approach to take, if the bank is saying it and the finance department is saying it's a good way forward?

Dr. Andrew Leach: I think the evidence lines up in favour of that generally, yes.

Mr. Nathan Cullen: I'm wondering whether there are any similarities historically, because we're seeing that this is not similar to the 2008 crash. This is potentially a supply side effect. This is a glut on the market right now. Is that fair, Mr. McLellan? Am I assessing that right?

My question is specifically this. I know they are different commodities and different industries, but how different is this than what we see on the gas side, and have seen for the last number of years? We have seen a new and large supply of gas without an increase in demand and prices have stayed persistently low for natural gas for how many years now? We're going back seven, eight —

Mr. David McLellan: Five, solid.

Mr. Nathan Cullen: Five years at least.

Is there a lot of difference between what I'm seeing now and the oil price?

Mr. David McLellan: The difference is in the magnitude. This should have been addressed earlier, but there are approximately 93 million barrels a day of consumption expected in global oil markets in 2015. Current production is just over 94.5 million barrels a day, so the excess supply looks to be about 1.5 million barrels. It might be as much as two million barrels, but as a percentage of global demand—

Mr. Nathan Cullen: It's a much bigger market than it is for gas.

Mr. David McLellan: Yes. It's not egregious.

Mr. Nathan Cullen: So a large increase in supply on gas has a depressive effect on gas prices for a longer time. A large increase on supply on oil is slightly different, is your argument, simply because the scale is different.

● (1110)

Mr. David McLellan: Yes, the oversupply in gas—gas being trapped in North America—was much larger. Most wells don't produce exclusively oil or gas. What happened in the last number of years when gas prices collapsed and oil prices went up, people drilled for liquids, and they got associated dry gas with that. Gas volumes continued to be produced, and whether or not somebody could make money on it was immaterial because they were making money on the liquids they were producing.

Mr. Nathan Cullen: Thank you.

I want to get to this question about discount for a moment. There's a discount on Canadian bitumen. Is that correct, Mr. Leach?

Dr. Andrew Leach: Absolutely.

Mr. Nathan Cullen: What is the different manufacturing cost for bitumen versus other oil products?

Dr. Andrew Leach: It depends a lot on the facility that you're putting it in, but generally speaking, globally, the heavy differentials reflect that processing cost. So if you think of a Maya to Brent differential, seven or eight dollars a barrel reflects two things. It reflects the processing cost. It also reflects the yield that you get out of a refinery, so you get a lower value mix of products out and you put more energy in to process it in a more complex refinery, so all of those things together—

Mr. Nathan Cullen: Makes our product, the bitumen product, a more expensive product to deal with—

Dr. Andrew Leach: More expensive and less valuable.

Mr. Nathan Cullen: —and less valuable. That contributes to there being a discount for Canadian bitumen.

Dr. Andrew Leach: Yes.

Mr. Nathan Cullen: I heard seven or eight dollars. I heard more depending, again, on the refinery that you're dealing with, the system that you're going into. The obsession about tidewater, I get it; it's a diversification of the market. Is it fair to say that the discount for Canadian oil is exclusively about market access? Or is it also the contributing factor to this higher input cost and fewer products coming out the other end at a lower value?

Dr. Andrew Leach: It's wrong to assume that a pipeline is going to turn bitumen into light oil. If you ship it to the coast, it's still going to trade at a discount that reflects its quality. You just lose that geographic discount.

Mr. Nathan Cullen: I've been taking a look at the gap between Brent and WTI. It fluctuates a bit, sitting at $10 to $11 today. It averages out less than that over the last year. Sometimes it's negative. WTI has gone in the other direction and been worth more, so it fluctuates as well.

One of the questions posed at the last panel was this. If we're looking at $50 a barrel—and we're going to take that price point, and it's been that way for a few months—are there any opportunities for the Canadian energy sector? Let's focus on that. We'll talk manufacturing later. Right now, does that $50 barrel offer us opportunities in terms of a change of policy and change of direction for the Canadian economy?

I'll start with you, Mr. Leach, and then perhaps Mr. McLellan or Mr. Schaefer could add in.

Dr. Andrew Leach: Certainly for anybody that burns oil or that uses oil, and refineries are included in that lower price, available feedstock is an advantage to them. In terms of the Canadian economy and comparative advantage, what we have that other people don't have is a massive oil resource. The world being flooded in oil, that's pretty well unconditionally bad news for our wealth as a country and for our comparative advantage as a country.

The Chair: Thank you.

Mr. Nathan Cullen: It's so interesting to spend so much time on this.

Thank you.

The Chair: Mr. Cannan, please.

Hon. Ron Cannan: Thanks to the ladies and gentlemen for being here today. It's another very informative discussion. I just want to jump right into the questions.

First of all, for Mr. Leach, I know my chief of staff follows you very well. I appreciate your comments. I'm from Edmonton originally as well, and spent time at U of A. We appreciate your opportunity to provide your experience here for our panel.

You were here earlier for the previous witnesses, who brought up *The Economist* magazine and how the Saudis and OPEC is indicating 400,000 additional barrels a day for 2015 and beyond. How long this goes on, we're not sure. Then our fine chair did a good summary as far as what the impact is.

I'm just wondering whether you believe the energy sector is in a crisis right now, and maybe elaborate on why you think the Saudis have done this at this particular time.

Dr. Andrew Leach: I think unconditionally you could call this a crisis in the sense that the price of your product has decreased by roughly 50%. There's almost no other way you can slice that.

In terms of what the Saudis are doing, I think it's the most talked about non-action that we've seen in global oil markets. They really haven't done very much. You talk about 400,000 barrels a day. That's a rounding error essentially on their production. If you look at most of what we talk about in terms of global oil production increase, it's not coming from the Saudis. It's coming from the small producers in the U.S. It's coming from our producers, etc.

I think what the Saudis would rightly see is that their ability or the OPEC's ability to wield their market power now is reduced by the fact that you have this new technology that Mr. McLellan talked about. You can drill a well, bring a well into production, and produce half the oil it's ever going to produce in about the first 12 to 18 months. It's hard to wield market power in that world because you pull production back now, you let prices go up and all of those rigs come back to activity. All those wells come back online, etc., so it's just a different environment for OPEC to be in. What you see from their actions is that, if anything, they're being less aggressive. They're not really flooding the market with any new production.

● (1115)

Hon. Ron Cannan: Okay, thanks.

Moving to Ms. Kent, I appreciate your industry helping and your association trying to help build Canada into a global clean energy superpower. I've been to several of the committee meetings over the years. Maybe you could expand, for the committee's sake, how this situation impacts the production of ethanol fuel from an energy supplier perspective.

Ms. Andrea Kent: One thing specifically in our sector that is pretty obvious from a policy standpoint—looking at the current price environment—is that the policies put in place in 2006 are working as they should. A big part of having mandated requirements for renewable content in our fuel pool is to mitigate and to plan for stabilizing demand in uncertain times. Looking at shrinking margins like we have right now, having those mandates and that policy stability is certainly very important.

We're fortunate here in that our mandates are by percentage. We don't have the same policy to the south, in the U.S., where they have volumes that are negotiated on an annual basis for their renewable fuel content. A lot of the ambiguity that we're facing right now because of the price environment is kind of added to because the EPA has not set those blend volumes for 2014 or 2015.

I think it is good to take a moment and reflect on the fact that we have policies in place that are working and that are helping stabilize demand for us in the face of these lower prices for sure. I think that it is also worth taking a look at how production has grown. We have been able to increase production to 1.8 billion litres of ethanol in Canada. It's impressive. Looking at growing out mandates is the next logical step to ensure that growth continues to pay forward and Canadian policies that are very strong continue to keep pace internationally.

Hon. Ron Cannan: Former colleague Bob Mills, who was here for a number of years, was passionate about using alternative fuel sources. I know he spent nine years in local government, and recently “The Management of Municipal Solid Waste and Industrial Materials” report was released by the federal government, looking at cellulosic ethanol as a supply. Could you maybe expand on how that will possibly help provide additional renewable fuel to the supply chain?

Ms. Andrea Kent: Absolutely. Yes, I know Mr. Gale; his group in Niagara is part of our membership now. We're really proud to have them on board.

The environment committee did good work in looking at the whole scope of municipal waste and how that problem is really affecting municipalities and communities across Canada. What a lot of people don't realize is that the feedstocks for renewable fuels have expanded and grown and now include solid municipal waste. When you look at cellulosic ethanol, which describes an ethanol or renewable fuel that can be made from products that include solid municipal waste, we can use that, decrease GHG emissions by 62%, and produce a clean burning fuel for our transportation fuel. It's really a double win.

Hon. Ron Cannan: Congratulations.

Ms. Andrea Kent: Thanks.

Hon. Ron Cannan: I know the concern in the south of course has to do with the corn and all the rest of the impact there, but we're looking at alternative fuel sources.

Mr. McLellan, congratulations to you and your company on your innovative technology for the oil and gas industry.

As the vice-chair of the Canada-U.S. group, I'm going to Washington in a few weeks and working with our colleagues and our biggest trading partner. I want to know if you could expand on a comment that President Obama recently made that Canadian oil has provided an extraordinarily dirty process. Would you agree with that comment?

Mr. David McLellan: Absolutely not. I find that comment offensive.

First, we have oil sands, which is probably what he was referencing, and then we have our own shale and conventional oils. Oil sands is the area I worked in before joining Packers Plus. I had brought American executives from a California oil processing facility up to our site. We shared a landing strip with Statoil. As we were descending, they were getting all excited looking out the window, because what they saw was pristine lakes and forests. We were doing in situ production. They said, “Man, this isn't what we expected.”

● (1120)

The Chair: I just need to remind members that they have to leave enough time for the witnesses, because we're well over time.

Mr. David McLellan: We do it better than anybody else.

The Chair: Okay.

Sorry about that; I apologize, but let's leave enough time for witnesses to respond.

[*Translation*]

Mr. Côté, you have the floor.

Mr. Raymond Côté: Thank you, Mr. Chair.

Dr. Leach, the first panel of witnesses mentioned earlier that the oil market was highly speculative. There has been a massive change in the past few decades.

We have talked a lot about supply and demand, but there is also oil as an investment vehicle. This explains—and you can confirm this for me—the sudden drop in the barrel price that we have seen in recent months. Basically, the fact that the market is very open accelerated this reasonably sudden drop.

To what extent could this “investment” factor, by which investors can more or less trust the future barrel value, influence things, either by sustaining a low barrel price or slowing the increase of the barrel price?

Dr. Andrew Leach: Thank you for the question.

[*English*]

Certainly there is a broad market in futures and options and all sorts of speculative trading in crude markets. What still anchors that market at one end is the operator producing the barrel. At the other end is the entity burning or using the barrel, transforming it into transportation fuels.

In the short term, absolutely you can see amplifications. In the long term, it has to come back to the same thing as it was in 2008, when there had to be someone willing to pay $147 to burn a barrel of oil. Today there has to be somebody willing to produce and deliver a barrel of oil to market at $50. That's really still the fundamental that underpins the market.

I think what you've seen more aptly, as Mr. McLellan alluded to, is that technology has changed in the market. It now allows more people to bring barrels of oil to market and make money at those lower prices. That's changed the game much more than speculative investing in the market.

[*Translation*]

Mr. Raymond Côté: I think another aspect is fairly important. Investors have seen this a lot when they wanted to make oil products transactions.

We haven't really heard much about the United States strategic oil reserve. If I've understood correctly, the Americans are trying to reduce this reserve because they no longer see the point of keeping it very high. However—and perhaps you can give me more details on this development—it seems that the reserve is being maintained, probably because of low prices and because they want to avoid intensifying the drop. That's a factor to be considered in the context of the transactions. Even if, in absolute terms, the impact is perhaps not as important, it can intensify the price drop on the market.

How much do you think a factor like this could influence prices in the future?

[*English*]

Dr. Andrew Leach: To my knowledge, there hasn't been any movement on the strategic petroleum reserve in the U.S. in response to the current price drop. What you have seen is substantial increases in non-strategic petroleum reserve storage in the U.S. and floating storage on tankers, etc., and people essentially betting on crude prices going up by storing crude oil, but that's not the strategic reserve. In terms of the strategic reserve, I don't really have anything to add.

[*Translation*]

Mr. Raymond Côté: Given these non-strategic reserves, we can suppose that a future increase may be delayed by a few months or a few years in order to get rid of the reserves held by various companies around the world. North America is still a specific market.

[*English*]

Dr. Andrew Leach: I think you can see that in two ways. You can see people holding that storage because they're expecting crude prices to increase enough to make holding that storage viable. It's just another aspect of the market. It's holding inventory as you would in any other commercial operation.

● (1125)

[*Translation*]

Mr. Raymond Côté: Mr. McLellan, do you have anything to add?

[*English*]

Mr. David McLellan: Just to address that—and it's not necessarily speculation—I can buy a barrel of oil today at $50, or I can sell it on the forward curve for $58. If my storage costs are 75¢ a barrel per month, I'm going to make money. A lot of this forward selling is already locked in.

[*Translation*]

Mr. Raymond Côté: How much time do I have left, Mr. Chair?

[*English*]

The Chair: You have one minute.

[*Translation*]

Mr. Raymond Côté: Perfect.

Ms. Kent, you spoke about the effect of the barrel price on other types of fuel, including biofuel. You said you are concerned about the fact that the price of a barrel could be kept low. I imagine that this has a fairly solid impact on the industry you represent.

In the long term, might this hurt the capacity to produce certain types of biofuel?

[*English*]

Ms. Andrea Kent: Thanks for the question.

So far our production has remained stable in spite of the prices. I think forward-looking continues to look positive for our industry. A lot of that has to do with the demand-stabilizing effects of the mandates, but a lot of it is to the credit of our membership as well. They've innovated. They're diversifying. Mr. Cannan talked about cellulosic technology, which is coming online. That's first-of-kind technology, but a lot of it is also being done by existing ethanol facilities that are diversifying, that are bringing in new technologies. I think this diversification needs to be supported going forward, because really—from an economic standpoint for us, for petroleum, and for everyone—diversification is competitiveness, and competitiveness is survival.

[*Translation*]

Mr. Raymond Côté: Thank you very much, Ms. Kent.

Thank you, Mr. Chair.

The Chair: Thank you, Mr. Côté.

[*English*]

Mr. Van Kesteren, please, go ahead for your round.

Mr. Dave Van Kesteren: Thank you all for being here. It's a fascinating discussion.

Mr. McLellan, you mentioned that peak oil is no longer.... I remember when I was first elected the big topic was that we were running out of oil. You're right that today we talk about how we have reserves for possibly 200 years. Nobody knows what the Saudis have; they don't seem to tell us. One of the aspects we haven't touched on is the fact that high oil prices encourage a lot of new development. Let's face it—although we no longer speak about peak oil, we have taken all the low-hanging fruit, from what I understand about drilling. Are we drilling seven miles down sometimes to get reserves somewhere in the Gulf of Mexico?

Mr. David McLellan: Incredible technology is in play to access oil today.

Mr. Dave Van Kesteren: I would suspect that with these low oil prices a lot of the development is not taking place. Are we in danger of possibly.... We know what our needs are globally per barrel. We know what we're producing and we know what we're going to need to produce, aside from what the Saudis have. Most countries know where they're positioned.

Are we in danger that when this all happens—because there hasn't been any new development taking place and when it starts to ramp up again—that they won't be able to supply the demand that's going to take place?

Do either one of you want to jump in?

Mr. David McLellan: As I addressed earlier there are about 1.5 million barrels a day of oversupply. Global demand is growing by about one million barrels a day.

Remember there are declines in oil fields all around the world. The oil sands have a unique profile.

In shale oil, as Andrew rightly pointed out, production can be brought on very quickly and taken off-line. Shale producers have become the swing producers in the world. As demand compensates or grows to take over the excess supply, and then continues its growth, shale oil out of North America is going to be able to meet that demand for a number of years.

I deal internationally with a number of other countries that have their own shale oil resources and are looking at how they can develop and how they can recreate the North American shale miracle.

We're not going to be in danger of any shortages, barring a major supply disruption out of the Middle East, Russia, Venezuela, or some of the more unstable areas. There is going to be lots there, but you're right in that it's going to be more expensive.

But then efficiencies.... Remember Moore's law with transistors? We're experiencing that in the oil and gas sector to some degree. The advances we're making in individual well productivity are increasing rapidly. How fast we can drill wells, put them on production, and how productive those wells can be is a magnitude better than it was as recently as 2005, and it's going to continue to increase. Companies like ours spend half our time figuring out what the next step is and how we can stay ahead of our competition.

● (1130)

Mr. Dave Van Kesteren: Mr. Leach, do you want to add something?

Dr. Andrew Leach: I think what we've seen in the transition is that we used to think of the global oil supply curve as being—and I don't know how you'll get this in the transcript, but I'm an economist drawing with my hands—a vertical inelastic supply. No matter how much prices went up there wasn't that much extra oil.

What we see now is not just due to shale oil, but also with technologies like we see in the oil sands with deep water, etc. The supply curve globally has flattened out. If you get into synthetics it's even flatter than that. We have much more oil available at a variety of prices than we would have thought possible in the past. It's just a change in the market.

Mr. Dave Van Kesteren: Nobody likes a recession, but I think you happily describe what happens when these sorts of things happen. We clean house and we get a whole lot better at what we're doing, so that's encouraging. I think we're going to emerge and be that much more competitive.

Can you possibly point us to.... Obviously the oil industry is going to have revenues. As our chair pointed out there will be less revenues for the government as a result of that.

In my neck of the woods we have a lot of greenhouses, and the low gas price has resulted in a boon for these people to be able to export their products to the United States. Can we see the same thing in Canada as a result of low oil prices? Can you direct us to some areas that are going to benefit and that would ultimately result in more revenue for the government?

Dr. Andrew Leach: I think the best summary of this is the Bank of Canada's recent statement that, yes, there are industries, consumers, etc., that benefit from low oil prices in the way you describe, but on the whole Canada is a net oil exporter. We are a resource economy to some degree, although not to the degree often painted. On a net basis this is going to be a negative, but that doesn't mean that it's a huge negative and that doesn't mean there aren't positives buried within. Transportation is the easy one.

Mr. Dave Van Kesteren: Ms. Kent, what is the maximum mix that you can have for ethanol and gas? I see 5%, and 5% is the government's mandate, but at what point will the manufacturer say that it's getting a little too high?

Ms. Andrea Kent: It really does depend, but mid-level blends like E15 are widely used in vehicles nowadays. Of course flex-fuel vehicles can take a high-level blend. When you have a flex-fuel vehicle it needs the cleaner fuel to derive the environmental benefits, and that's where market access becomes important.

Mr. Dave Van Kesteren: We have lots of room for expansion again.

Ms. Andrea Kent: Indeed.

The Chair: Thank you, Mr. Van Kesteren.

I'm going to take the next round.

Mr. McLellan, you describe very well your company. It's very innovative. I certainly applaud you for that. But your company and others like you have transformed the energy market in the world, right? You have successfully done that. As you said, you ushered in a new era.

If you look at production—I hope these figures are correct—U.S. production of crude was, in 2008, five million barrels a day. In 2014, I think it was 7.4; 2015 is projected to be 8.5; and 2016 is 9.3. I hope those figures are correct, but it shows obviously a trend in terms of supply. As you mentioned, demand is going down, so you have transformed the market.

Mr. Leach indicated that the Saudis are perhaps being less aggressive than they could be, but the sense is that, and many observers are saying this in fact, what they are doing is trying to preserve market share. If you look at it from a very cynical point of view, they are almost trying to either halt your progress or even drive you out of business, such that they preserve their market share where it is today.

Given that—and that may be the reality, I'm not saying it isn't—how will your company and others respond to that situation?

Mr. David McLellan: First, slowing the growth of the shale oils is one of their imperatives. They have already lost tremendous market share in the United States. They used to be the number one supplier. Canada's now the number one supplier. Saudi's exporting less than a million barrels a day into the United States, so defending market share is a big part of their goal.

Another part of their goal would be to slow the growth of competitive fuels. Lower prices are going to reduce demand there... to hurt some of their strategic enemies if you will, Iran and Russia. There are a lot of things that play into their rationale, but they are taking a very rational approach from an economic perspective. They are the lowest cost producer in the world.

In terms of our business, yes, it's going to slow down our North American business considerably, but we do deal with Saudi Arabia. We have some systems in the ground in Saudi and in all parts of the world. We have offices everywhere. As long as there is shale oil tight gas resources, our company is there. It's a double-edged sword.

The more hydrocarbons we bring on and the faster and cheaper we bring them on, the less likely the price is to recover to say $100 a barrel, but then on the macro picture, the more that benefits consumers. It's about productivity and we are making the industry more productive.

● (1135)

The Chair: But if their goal is to in fact preserve market share and in fact do harm to companies like yours so that your production actually goes down and not up, as the numbers I quoted at the beginning.... My understanding of companies like yours in the industry is that, if in fact you do take it down, you can ramp it up very quickly. So the Saudis cannot have the strategy over a five-year or 10-year period.

I'll get Mr. Leach to comment on this.

I'm not really sure. This is why I guess I'm so uncertain as to where we're actually going on oil prices if their goal is to do this. Suppose your production did ramp down instead of go up, and they fulfill that goal in the short term. The fact is, once they stop that policy, which they will have to do at some point, you will just ramp up again, and they are in the same spot.

Mr. David McLellan: That's the role they are conferring upon us as the swing producer. That was a role they historically played, and now they are saying you know what? U.S. shale can do it. We're just going to defend.

They are at approximately 9.7 million barrels a day of production. Russia's number one. Saudi is number two. They don't have the capacity to go probably beyond 11 million barrels a day.

The Chair: Mr. Leach, do you want to comment on that?

Dr. Andrew Leach: It comes back to what I had said earlier, that really what we're seeing from the Saudis is non-action. It is continuing to produce much as you would expect a competitive producer to act.

What they have seen is an erosion of their market power from the factors that Mr. McLellan mentioned. The Saudis used to have the ability to create a low price environment that would shut out high-cost producers, and then to step back their own production, see prices rise, and take advantage of those rents. Now they don't have that second part.

They could cut production now. Prices would bounce up, but who would fill that gap? It would be more light oil production in the U.S., etc. They wouldn't have the ability to then profit from those high prices in the same way.

When you hear people talking about competing on market share, that's kind of the story. They know somebody else is going to flood in on them, be it alternative fuels or other producers. I think you're really seeing a non-active response. I wouldn't quite characterize it as actively as conferring a hat on the U.S. swing producers as Mr. McLellan did. It's just the reality of the new market.

The Chair: Are they caught in almost a catch-22 then in the sense that they don't really have an option here?

Dr. Andrew Leach: I think they are just more of a competitor. They just don't have as much market power as they used to, so they don't have as big a stick to wield.

The Chair: I love the two-handed economist comment. I think Harry Truman famously said, "Give me a one-handed economist" so he could actually have one option.

You did say not all our eggs are in one basket. One of the criticisms of the Canadian government, certainly not by me but by other people, is that the current government has put all its eggs in one basket in terms of the energy sector. You said that is clearly not the case. I just wanted you to expand on that.

Dr. Andrew Leach: If you look at Canada, whether with regard to our energy and resources or whatever Statistics Canada basket you use, most of our resource dependency is decreasing over time. It hasn't increased under the term of your government or even in the last couple of governments. What we have probably seen is more rhetoric around that. If you went out and asked Canadians how dependent they are on the oil industry, I think they've been told over and over again that it's the engine of our economy. So it's natural for them to think and buy into this idea that this is the only thing. The other part is our focus on deficits versus total government expenditures. If you look at Alberta as an example of this, we just saw Alberta government revenues shift by a projection of $900 million, but that took them from a deficit to a surplus. That's a $900 million shift on a $46 billion annual revenue, or whatever their total number is. It's a relatively small shift, but it seems large because we are focused on deficit versus surplus.

The same thing is true at the federal level. We are really interested in whether we are going to be in deficit or in surplus. Saying the price of oil is going to drive that makes it seem as though it's a much larger share of the overall economy than it actually is.

● (1140)

The Chair: Can I ask you one final question? The governor of the Bank of Canada seemed to indicate that there is a negative effect on the Canadian economy but that negative effects are largely short term, whereas the positive effects one might see, especially from the depreciating dollar, are more medium term. Would you agree with that analysis?

Dr. Andrew Leach: I didn't see that particular comment. I saw him saying it was maybe a front-loaded oil shock.

The Chair: That may be my comment on what I read.

Dr. Andrew Leach: I didn't see that particular comment. I think we do see that it is going to take a while for the demand side to adjust and take advantage of low prices here, but that's not a uniquely Canadian thing. That's everywhere. It's in the U.S. economy. It's in the global economy.

I think we also need to realize that the effects, like the effects of the boom, are unequally distributed, so whereas Alberta took the lion's share of the benefits in the upswing, it is also going to take the lion's share of the costs—Alberta, Newfoundland and Labrador, and Saskatchewan to some degree.

I think there will be a net positive, as the governor said, but bear in mind that there's a lot of story underneath that regionally, provincially, etc.

The Chair: Thank you.

I want to thank all of you for a fascinating discussion here this morning. If you have anything further you wish the committee to consider, please submit it. We will ensure all members get it. Thank you so much.

Colleagues, I would ask the parliamentary secretary and the vice-chair and perhaps Mr. Dubourg just to stay back for an informal discussion with me after the meeting.

The meeting is adjourned.