

The Fate of Alberta's Oil and Gas Industry

By Keith Kohl | Monday, March 15th, 2010

I knew a change was on the horizon.

Even my Canadian readers in Alberta who felt they weren't getting their *fair share* had to have known the royalty time bomb had to be defused. Let's face it: the [Alberta oil and gas royalty changes](#) were inevitable.

To say the majority of my Canadian readers (particularly those living in Alberta) felt that Alberta had lost its competitive edge would be an understatement. Now that the changes have been announced, I'm curious as to what you think. Feel free to leave a comment by clicking below.

Like I've said before, it was only a matter of time...

Keeping Alberta's Oil and Gas Industry Competitive

Before I get to the announced changes, let's clear the air over Alberta's oil and gas troubles.

Make no mistake; Alberta is an absolute powerhouse when it comes to Canadian energy.

Approximately 80% of Canada's natural gas production comes from Alberta — about 5 Tcf per year. If you're counting, that's enough to heat every home in the province for three decades.

I've talked about the growth of Canadian oil imports to the U.S. over the last two decades in previous articles. Out of the nearly two and a half million barrels exported to the U.S. every day, *more than half* of that number came from Alberta.

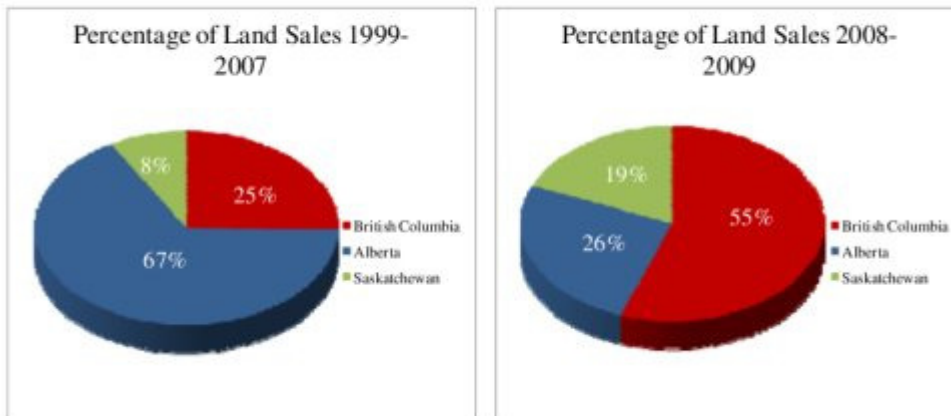
And yet, at the heart of last week's royalty cuts is keeping Alberta a competitive contender in the Canadian oil and gas game.

Although Alberta's oil and gas industry plays such a large role in the Canadian energy picture, there's no denying that the province has lost a step or two over the years.

When Alberta's premier, Ed Stelmach, went to give Albertans their *fair share*, he ended up alienating oil and gas companies.

Here's a perfect example of how interest has shifted away of Alberta:

Percentage of Western Canada Land Sales (1999-2007 vs. 2008- 2009)
Source: Alberta Department of Energy - Province of British Columbia, Government of Saskatchewan



I know what you're thinking... Alberta's land sale last month for conventional oil and gas drilling rights reached a 14-year high, right?

While it's true that there's been a renewed interest in certain oil plays like the [Cardium oil formation](#), one month doesn't change the trend.

And in some respects, Alberta's conventional oil and gas industry is sliding down the backside of the peak oil curve... but I'll get to that in a moment.

Kneeling Before the Oil and Gas Industry

Last week, Ed Stelmach must have gotten up early, put on his best rosy lipstick, and puckered-up for the oil and gas companies that haven't jumped the provincial borders into B.C. and Saskatchewan.

Unfortunately, he's doing nothing more than playing dirty political games.

In one swift move, Stelmach slashed top royalties rates for conventional oil from 50% to 40%. Meanwhile, the maximum rates for unconventional and conventional natural gas were cut to 36%, down from 50%. The changes will be effective January 2011.

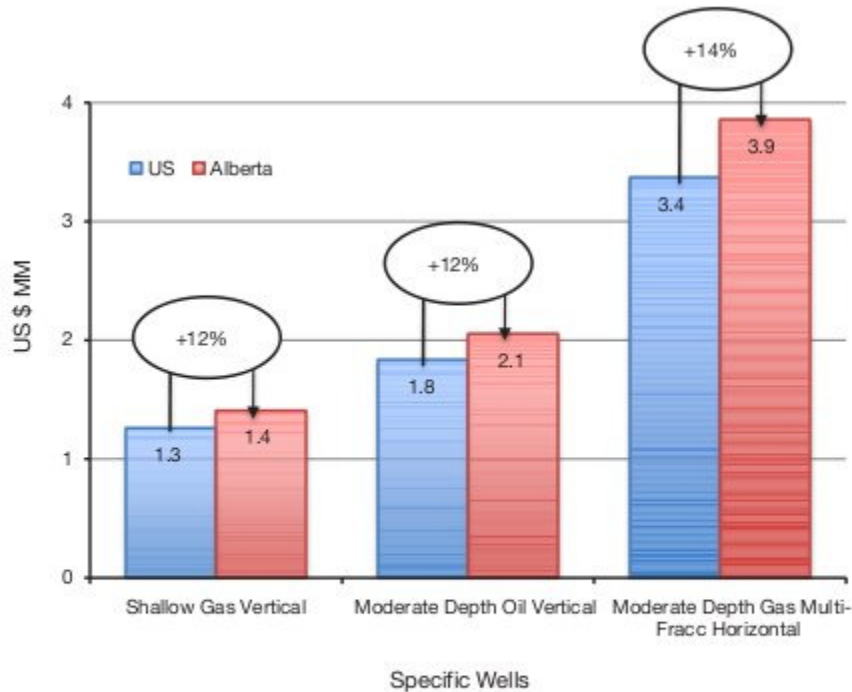
One point I can't ignore is that rates for unconventional oil — the oil sands in northern Alberta — were untouched. Keep that in mind.

In the Grips of Peak Natural Gas

As my readers are well aware, much of Alberta is covered by the Western Canadian Sedimentary Basin (WCSB), a massive wedge of sedimentary rock extending from under the Rocky Mountains. It's no secret that the WCSB contains a huge amount of oil and gas reserves.

And while the WCSB has many years of production ahead, production has been declining for nearly a decade. [Peak natural gas](#) has hit Alberta hard. One of the effects is that conventional oil and gas resources are more expensive to extract.

As you can see below, Alberta hasn't been able to keep up with the U.S. in drilling costs:



Comparison of Well Costs between Alberta and the United States, 2009

Source: IHS CERA

Furthermore, if you're looking to play those natural gas companies in Alberta — hoping to catch a ride from the latest royalty changes — you might be disappointed.

It's not that I have some Stelmachian agenda against the natural gas players operating in Alberta. The problem isn't in the royalty changes, but rather in the natural gas market itself.

To say there's a supply glut plaguing the North American natural gas market would be a sore understatement, and we still haven't seen enough from the economic recovery to boost industrial demand.

As you know, natural gas prices have languished since collapsing in 2008...



Also consider that we are heading away from the winter months, the time when natural gas demand is traditionally at its highest. Even a scorching hot summer may not be enough to call for a comeback.

So if we're supposed to focus on the natural gas side of the equation, what can we expect from Stelmach's political U-turn?