AIMS commentary

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The Rules of Oil & Gas:

Why Newfoundland's Offshore is Drying Up.

by Peter Fenwick
AIMS Fellow with Responsibility for Fisheries and
Issues in Newfoundland

Newfoundland and Labrador Energy Minister Ed Byrne wonders why no new significant oil fields have been discovered in the last twenty years in the offshore.

He should wonder no longer.

The failure of the oil industry to find new fields in Newfoundland is primarily the result of capricious and unstable government development policies that discourage oil companies from investing. Until the offshore regulations become fair and predictable, Newfoundland's offshore is likely to stay as undeveloped as it is.

Newfoundland has a basic decision to make when it comes to developing the offshore oil industry. Does it want to extort every last job and every last economic benefit from the four fields that have been discovered, and risk discouraging oil companies from ramping up their exploration activity; or does it want a vastly expanded exploration effort spurred on by fair and fixed rules for development once the oil fields have been delineated? It cannot have both.

So far the province has given mixed signals when it comes to development. The first oil field, Hibernia, negotiated when oil prices were low, resulted in a massive series of subsidies from both the provincial and federal governments. Subsequent developments on the Terra Nova and White Rose fields were less complicated and, with a generic royalty scheme in place, resulted in straightforward development. Although the province insisted on much of the construction being done in the province, in the end the oil fields went ahead in a straightforward manner. That is 'til now.

The fourth field, Hebron Ben Nevis, has had a long and tortuous row to hoe. It was initially shelved as uneconomic a few years back when oil was selling for much less than today's inflated prices. But at $60 a barrel the field is viable again and talks between the Williams government and the proponents have started in earnest. However, instead of allowing the companies to proceed under the generic royalty regime, the provincial government is insisting on a flock of new conditions. Among the new conditions is the requirement to build an oil refinery in the province and an obligation to fork over an equity position in the oil field.

Given the total profit the province gets on royalties and corporate taxes under the revised Atlantic Accord, subsidizing jobs by forfeiting revenue makes no sense at all. And while it may make economic sense for someone to build a refinery in Newfoundland and Labrador, making it a condition of developing Hebron Ben Nevis just gives the oil companies additional chips to bargain with.

The provincial government points to the equity position that the Government of Canada holds in the Hibernia field as a precedent for its insistence on an equity position in Hebron Ben Nevis. What the government does not acknowledge is the fact that Canada injected that equity into Hibernia in order to keep the project afloat when one of the original Hibernia backers bailed out. The province proposes to do exactly the opposite: that is, to buy in when oil is dear. The stake will be expensive, either in cash, or in the terms required by the oil company to give up a share of the field. Canada bought low, Newfoundland would buy high.

And while it would be an example of economic lunacy for a government to buy back into an oil company when most jurisdictions in the world are moving in the opposite direction, the greatest harm is done by the huge red flag the attempt at extortion raises for all the other oil companies who might want to invest in Newfoundland's offshore.

The proponents for Hebron Ben Nevis would be extremely reluctant to walk away from that money despite the extortionate behaviour of the Williams government. They may have to make the best of a bad deal. But other oil companies contemplating investing in offshore Newfoundland may decide that the risks are much too high for them to invest in a jurisdiction that changes the rules of the game every time it feels like it.

And while it is impossible to quantify the loss when people decide not to invest, the fact that Newfoundland has seen over two decades pass since the last oil field was discovered should indicate that the oil companies are reluctant to commit billions when they have no assurance that they will be able to make a decent profit from the resource.

There is a price to be paid for changing the rules — often people refuse to play at all.

Peter Fenwick is a Research Fellow with the Atlantic Institute for Market Studies. He is a former member of the Newfoundland legislature and former Leader of the New Democratic Party in Newfoundland & Labrador.

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