

Yard Work

Exploring Natural Capital Public Policy Issues

What about the energy industry?

Introduction

If there is one resource that Alberta is known for—not just within Canada, but around the world as well—it's energy. Whether conventional oil, natural gas, bitumen, or coal-bed methane, it is obvious that Alberta has a lot of it. And given that the Government of Alberta holds 81% of the mineral rights in the province, the people of Alberta themselves control the majority of these resources. This control provides Albertans with obvious financial benefits, but the energy sector has costs associated with it as well. While the province has recognized the value of successfully managing subsurface natural resources because of their importance to Alberta's economy, it has done a less convincing job of developing public policy mechanisms and tools that connect what is happening below the ground to what is going on above it. Of course, the two are inextricably linked to one another.

The Challenge

Alberta's energy tenure system—the process through which energy development occurs—is an indication that the industry needs a new tool to help them improve their long-term land use practices. Energy tenures are short-term, cover relatively small areas, are regulated by those possessing them, and present the obvious problem of requiring management of a resource that is underground. Combine this with the fact that the system is primarily structured to generate maximum revenue, and certain implications arise with respect to the effects on the land. First, the energy sector spends most of the tenure cycle determining reservoir location and comparatively less time considering surface attributes and challenges. Second, the small area involved, in concert with the current regulatory process, provides little opportunity to look at broader landscape issues or those associated with

the cumulative impacts of multiple developments. Finally, the competitive nature of the industry lends itself to short-term planning with little incentive for considering wider issues. In short, Alberta's current energy development process does not allow for broad connection to the surface implications of resource use.



The term "Yard Work" is a spin on a statement frequently made by Alberta Premier Ralph Klein: "It's time to get our economic house in order." As well as getting our economic house in order, we believe that it is important to work on the "yard." The Canada West Foundation's **Natural Capital Project** is based on the premise that the "yard" (i.e., our stock of environmental assets) is critical to not only western Canada's quality of life, but to its long-term economic prosperity as well. As such, the Project seeks to close the counterproductive gap that exists between environmental and business interests, and stresses that natural capital is not a luxury, but a primary economic asset. The *Yard Work* series contributes to this by identifying, exploring, and encouraging debate about natural capital issues and ideas for improving public policy in this critical area.

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The nature of this system was not a problem when there was not as much demand for energy development. Traditionally the Government of Alberta would manage the impacts of energy development on the land. However, while exploration and extraction activities have grown rapidly, the Government of Alberta's capacity to deal with issues of integration and land management has not kept pace. As it stands now, the province has no integrated processes in place to right this wrong. Furthermore, because the provincial government traditionally undertook land management activities, the industry has not evolved the mechanisms to deal with cumulative impact issues. On its own this problem is a big one, but as the intensity of energy development grows, and as our knowledge of its effects on the land and water of Alberta grow along with it, it is essential that the province provide the tools to begin addressing these important issues.

The following will provide the energy sector, the Government of Alberta, and Albertans in general with a tool that will enable industry to begin to deal with the current limitations of the regulatory systems in which they operate. The recommendation draws upon the experience of another resource industry in Alberta—forestry—in suggesting the creation of a program through which the energy sector can invest a portion of the revenue from resource development into policy, research, and stewardship programs that target the cumulative impacts of development on Alberta's land, water, and air. For the Government of Alberta this is an easy policy win—a change that allows the energy industry the freedom to improve management of Alberta's natural capital with that sector's own funds. For the people of Alberta it is even better; it will promote the protection and enhancement of Alberta's natural capital for generations to come.

The Way it Works

The energy industry may be the largest Alberta resource sector in terms of financial contributions, but forestry dominates in sheer geographic size. Some 60% of the province is covered by forests, amounting to over 38 million hectares of land. Given the vast area of forests, as well as their economic, environmental, and social benefits, all Albertans have an interest in how this natural capital is managed.

As part of the Klein government's delegation of governmental responsibilities during the 1990s, responsibility for the delivery of three programs aimed at contributing to the sustainable management of Alberta's forests was transferred to the Forest Resources Improvement Association of Alberta (FRIAA). One of these, the Forest Resources Improvement Program (FRIP), was mandated "to support projects that enhance forest resources or the management of forest resources for the benefit of all Albertans."

FRIP functions by providing funding for projects that will contribute to its mandate. These projects fall under four major categories: operational field work such as changing the attributes of the land to improve forest characteristics; inventory and planning with respect to forest data; applied research; and other activities to enhance forest resources and forest management, such as educational programs. In 2004, FRIP project funding in these four categories amounted to some \$10.5 million.

Funding for FRIP comes from forestry companies in the form of payments to FRIAA. A company pays dues into the FRIP program based on current timber rates and can then apply to use this money for project funding. The FRIAA Board of Directors must approve all proposals, and funds must be used in one of the four manners

This document was authored by Canada West Foundation Intern Chris Fay and Senior Fellow Barry Worbets and is part of the Canada West Foundation's *Natural Capital Project*. The authors wish to express their thanks to Bob Demulder for his thoughtful contributions. The *Natural Capital Project* is a multi-year research and consultation endeavour that promotes the importance of the environment to western Canada's economic prosperity and quality of life. The project promotes the need to find a public policy balance between short-term economic growth and long-term investment in natural capital. Funding for *the Natural Capital Project* was provided by Alberta-Pacific Forest Industries Inc., Ducks Unlimited Canada, EnCana Corporation, Shell Canada Limited, and Suncor Energy Inc. The Canada West Foundation expresses its sincere thanks for this generous support. The opinions expressed in this document are those of the authors and not necessarily those of the Canada West Foundation's Board of Directors, advisors, or funders. Permission to use or reproduce this report is granted for personal or classroom use without fee and without formal request provided that it is properly cited. Copies may not be made or distributed for profit or commercial advantage. This document can be downloaded at no charge from the Canada West Foundation website [www.cwf.ca].

described above. As well, other bodies such as universities or environmental organizations can apply for open FRIP funds as long as their proposals meet the mandate of FRIAA.

In summary, FRIP provides the forest industry with a pool of dedicated resources to be used for any policy, research or program that improves the sustainability and stewardship of the forest and the land that supports it. This generates direct benefits for Albertans while indirectly benefiting the industry.

The Reasons it Works

By all accounts, FRIP has been very successful in contributing to the sustainable management of Alberta's forests. The reasons for this are manifold. First and foremost, the FRIAA Board of Directors is made up of a variety of industry stakeholders, from forestry company executives to government officials to individual Albertans with a background in forestry. This diversity of views ensures that different positions are espoused when applications for projects are considered, as well as encouraging direct participation in the bettering of Alberta's forests. Second, FRIP was instituted at a time when the forestry industry was establishing active management of forests and had the resources to fund the program. Third, FRIP has universal membership amongst Alberta's medium- and large-size timber companies, thus providing an important voice to the largest users of the resource. This ties into the fourth point: one of the major benefits of FRIP is that it directly involves forest companies in the management of their livelihoods, while at the same time ensuring a voice and benefit for all Albertans. Finally, and an integral point, FRIP only provides funding for projects deemed to go above and beyond applicants' existing regulatory responsibilities and monies may not be used for capital assets. Forest companies applying for project funding are doing so not because they have to, but because they want to.

The Applicability to Energy

A similar program for energy need not be a carbon copy of FRIP. In fact, duplicating the forestry model would likely prove unsuccessful in energy (there are 31 FRIAA members compared to about 1,900 oil and gas companies). What should be replicated is the set of principles that have led to the success of FRIP in the forest sector. It is essential that both industry and government be able to understand and mitigate the long-term effects of development, extraction and usage—not just for ecological benefit, but for social and economic benefit as well. Providing a tool that allows for a portion of the revenue from resource development to be invested in these programs when it is unclear whose responsibility—government or industry—it is to do so is the first step.

Of course, the energy sector and the forest sector are two very different industries. Forest tenures are large in area, laden with existing long-term planning requirements for sustainable management and do not generate the volume of revenue that is provided to the province through energy tenures. But if the case can be made for FRIP as a tool to address the shortcomings of the forestry system with respect to broader social license issues—and it can, given the success of FRIP—then a strong case certainly exists for the oil and gas sector to have a similar program.

As the respective owners and developers of the resource, both government and industry are responsible for ensuring the sustainability of the oil and gas sector at the surface level. Currently, neither are doing enough to fulfill this responsibility. For industry, a smattering of the largest companies have the potential for this type of planning, and some good work is under way by organizations like the Cumulative Environmental Management Association, the Canadian Association of Petroleum Producers, and the Petroleum Technology Alliance of Canada. But the sector is hindered by the fact that funding for other projects must be justified within the confines of relatively small exploration and production projects operated by thousands of companies. Because of this internal sector restraint, most oil and gas companies cannot economically justify long-term, broad initiatives.

The benefit of FRIP is that it enabled the forest sector to start to overcome these problems and begin dealing with issues and challenges that fall outside the scope of existing regulations. Clearly the energy sector would benefit in the same way.

The People who Should be Included

Just as FRIP aims for universal membership amongst forestry companies, an energy fund must do the same for oil and gas. Many of the major players in energy already engage in significant research with respect to sustainability, but the key to a successful program is involving all those who have an effect on the land. If the program functions as FRIP does—allowing for stakeholder ownership over decision-making—then all those who are members will receive the benefits of project funding.

There is one important element of the FRIP model that must not be replicated in the development of a similar program for the energy sector. FRIP applies exclusively to companies that deal in softwood lumber. Alberta's energy industry is so comprehensive and the nature of energy resources so integrated that a program applying to only one resource—e.g., natural gas—would simply not work.

For Example:

A small company acquires coal-bed methane leases along the eastern slopes of southern Alberta. This gives the company the right to explore and develop the resource. However, the ranching community opposes the development because little information exists to prove that reclamation of native grassland can be accomplished. The company cannot afford the cost of major reclamation research initiatives, and the ranching community cannot afford to have the native grassland permanently compromised. Dedicated funding would allow this research to be undertaken, benefiting not just the small company and the ranching community, but also providing information to all energy companies.

For the energy sector, there is an important indirect benefit to such a program as well. Fundamental to the energy industry operating in Alberta is the tacit permission of the people who possess the resources. That is, Albertans must grant the energy sector the social license to operate. Given the massive boom in oil and gas and the ad hoc nature of energy development at the present time, this social license to operate is increasingly at risk. Enabling the industry to deal with the issues and challenges of surface effects is one way of confronting this problem.

The Costs

As in any endeavour as widespread as this one, there will be costs involved. One concern that has developed around the FRIP program is that it is often seen as a “go to” for research dollars from non-industry interests. Ensuring resources are invested in projects that contribute to the alleviation of the cumulative impact of development on land, water and air resources can assuage this concern.

Another possible issue may be the view in the oil and gas industry, especially amongst smaller producers, that the fund is simply a “money grab” by the government. This will depend largely upon the financing system established to fund the program (see the discussion of policy implications below). However, the benefits of such a program, both within industry and beyond, should negate any costs involved. Time and time again in discussions with resource industries, the Canada West Foundation hears that the current ad hoc nature of

Alberta’s energy resource system hinders the ability to mitigate the cumulative impacts of resource development. Just as it did for the forest sector, the creation of a dedicated research investment fund for energy will help to overcome this concern.

Similar to this concern is the potential that such a program be viewed as a subsidy for the energy sector. This is especially true if financing for the program were to come from existing royalty payments, in effect allowing the energy sector to engage in initiatives with money that would otherwise be paid to the province. This worry is eliminated by stressing the larger societal gains provided by such a tool, as well as by opening the fund to non-industry interests.

Policy Implications

As the largest contributor to Alberta’s economy, the energy industry has tremendous effects on the province. The idea of a tool designed to deal with some of these unanticipated effects makes sense. However, as the old saying goes, the devil is in the details. No matter how it functions, if the process is to be successful it must be supported by two overarching principles. First, investment of a portion of resource revenue to understand and mitigate the cumulative impacts of energy development is a necessity, but funding must only go beyond the industry’s current responsibilities. Second, and integral to the political success of such an initiative, the program must be revenue neutral. This means that the Government of Alberta may initially have to support the program with funding, but the fund itself will be financed through industry contributions. Any initial government investment will be more than made up by the benefits produced by the fund.

With these two principles in mind, there are a series of policy implications that must be considered by the provincial government in establishing this program in Alberta:

Creation of a Delegated Administrative Organization

This would allow the government to reap the benefits of the fund while having its actual management occur at arms length.

Management of the Program

Any number of management mechanisms exist (e.g., the FRIP model, an offshoot of the Alberta Energy and Utilities Board). The key is involving stakeholders and citizens in the process.

Financing

Again, different mechanisms for financing the program exist—e.g., prices and quantity of production, area disturbed.

Start-Up Money

Pivotal here is the political will to establish the program. Keeping in mind the overarching principle of revenue neutrality, the government must understand the gap that such a program will fill (arguably, an existing governmental responsibility) and the benefits that it will spawn.

Size of the Fund

The program does not necessarily have to be large in financial size, and, depending on the financing mechanism, it may be more politically viable to keep it at a relatively small level (e.g., \$10 - \$20 million).

Significant Contribution to Government of Alberta and Ministry of Energy Business Goals

For example, the 2005-2008 Ministry of Energy Business Plan calls for both “Unleashing Innovation” and “Leading in Learning,” two areas where this tool could play a tremendous role.

Integration of Research and Technology

Government should consider knowledge and actions that result from program funding in its future decision-making processes.


Conclusion

In the energy sector’s current state, neither government nor industry has the capacity to effectively tackle the cumulative impacts of resource development on the land. A similar problem challenged the forest sector in the mid-1990s as the need for a more robust planning

process became obvious to that industry. The creation of FRIP empowered forestry companies to begin dealing with issues and challenges outside their regulatory requirements by bringing the affected stakeholders to the table, and has contributed much to sustainable forest management. The oil and gas sector needs a similar program.

However, for such a program to come about there is one critical factor that must be present: political backing. The energy sector will not establish this on its own. While support from industry is pivotal to success, the first step in this process must be a politician or party willing to throw their weight behind the proposal. Think of it as a legacy project or an investment in the future.

The investment has applicability outside Alberta’s borders as well. In virtually every resource sector there are unforeseen consequences to the development that is occurring. A pool of dedicated resources to be used and, more importantly, controlled by industry in order to facilitate an understanding of how to mitigate these consequences is an invaluable tool anywhere in the country. The key is stakeholder participation.

The question this discussion paper has tried to answer is: can the Forest Resources Improvement Program model be applied to the energy sector? For the direct and indirect benefits that such a program will provide the oil and gas industry, the Government of Alberta, and Albertans as a whole, the answer is yes. 

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