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## PRESENTATION TO THE ALBERTA ROYALTY REVIEW PANEL

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### **Attachments:**

- 1) Profile, HSE Integrated Ltd.
- 2) CV – David Yager

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### **OVERVIEW**

HSE Integrated is a Calgary-based, national supplier of industrial health, safety and environment services. With its roots in Alberta's oilpatch, HSE has expanded to become the largest company of its type in the world and the only national supplier of these services that are essential to the protection of workers, assets and the environment. A company profile is contained in Attachment 1.

HSE has three main stakeholders – employees, customers and capital providers. It is on behalf of these three groups that I make this presentation today.

As for me, HSE's Chairman and CEO, I am a second-generation oilfield service professional who has been active in Alberta's oil and gas industry since 1970. I have been involved in the creation of three successful publicly traded oil service companies that have used their Alberta base for national and global expansion. Through a career in publishing, newspapers and the electronic media from 1979 to 1992, I have also been an analyst and commentator on federal and provincial energy policy for 28 years. My CV is contained in Attachment 2.

It is from this platform of a combination successful oil service entrepreneur and a student of Alberta's oil history that I have developed this presentation.

The current Alberta hydrocarbon royalty regime was developed over the past 34 years with the following objectives:

- 1) A flexible fiscal regime that encompasses the diverse nature of Alberta's vast hydrocarbon resources
- 2) Provide some degree of stability against a background of volatile commodity prices
- 3) Ensure a financially sound and dynamic private sector
- 4) Through administration of resources by the provincial government, meet the needs of resource developers and Albertans

Originally Alberta's royalty regime was purely administrative – to provide a framework for the leasing, development and management of petroleum mineral resources. This was highly successful and helped create our industry.

Beginning in 1973 the royalty regime became highly politicized and an instrument of government policy. While this seemed like a good idea at the time, this new application of the royalty system that began in the boom of the 1970s became a major obstacle to the industry's continued growth and success. The province suffered.

In the early 1990s the royalty regime was largely depoliticized and prosperity returned. Having Alberta move to a more administrative role provided the foundation of the enormous prosperity our province has enjoyed, and may continue to enjoy depending on the outcome of these hearings.

The Royalty Review process in which I am participating today is in response to recent history and the belief that the "big picture" economic realities that dictate the profitability of hydrocarbon development have somehow changed.

There is a major attempt by opposition political parties and Non-Government Organizations (NGOs) to re-politicize the royalty system for objectives other than the safe, profitable and orderly development of Alberta's oil and gas resources.

Through nearly three decades of massive commodity price and federal and provincial energy policy fluctuations, I have detected only two clear and predictable trends:

- 1) Industry and government cannot forecast accurately but tend to believe that current conditions will last indefinitely. We're "extrapolators", not predictors.
- 2) The current view of industry conditions is always wrong.

I fear the Alberta royalty review process is in response to the events of the past four years – high commodity prices, favorable capital markets, benign

government policy and unprecedented growth - and external political factors not related to sound management of Alberta's hydrocarbon resources.

The "boom" of the past four years has already begun to correct itself, and any significant change in provincial government policy based on the recent past is not the right approach to our collective future.

The political pressure that has led to this review is a welcome and essential part of Canada's open democratic process. However, the old saying goes, "If it ain't broke, don't fix it".

Re-politicizing Alberta's royalty system to increase the Crown's share for other purposes than resource management would be a serious mistake detrimental to the long-term needs of our province.

Further, increasing the Crown's share would most certainly have a negative impact on our company – HSE Integrated Ltd. – and our three main stakeholders – employees, clients and capital providers. I remind you that I speak today on behalf of the careers and families of 500 HSE employees in Alberta and hundreds of shareholders in this province and across Canada.

I am here today to plead with this panel not to kill the geese that have laid so many golden eggs, and to urge the panel not to allow external political forces to hijack the development of hydrocarbons by the private sector.

### **THE PAST: 1914 – 1991**

#### **Resource administration become political with disastrous consequences**

*"Those who cannot remember the past are doomed to repeat it" – George Santayana, 1905.*

Regulatory and administrative control of subsurface mineral rights not owned by individuals was transferred from federal to provincial control in 1930, hence the term "Crown" mineral rights. This was after the early natural gas discoveries at Medicine Hat, Bow Island and Turner Valley but before the major discoveries of crude oil at Turner Valley in the late 1930s and the Leduc discovery in 1947.

It was the Leduc discovery that put Alberta on the map as a major hydrocarbon producing region. What followed through the 1950s and 1960s were further major oil discoveries at Redwater, Pembina, Swan Hills, Slave Lake, Rainbow Lake and natural gas at places like Jumping Pound and Waterton. All these discoveries required the development of significant infrastructure in the form of pipeline gathering systems, gas plants and refineries. Major export pipelines for oil and gas to the east and gas to the west were constructed to turn these discoveries into cashflow for the producers and the Crown.

During this period what also developed for the first time was a domestic drilling and service industry. While the bulk of the equipment and services were originally provided by Americans, by the 1960s the entrepreneurial nature of Albertans became obvious as local outfits sprung up to meet the needs of E&P (exploration and production) companies operating in Alberta.

With the exception of oilsands development, by the early 1970s the oil industry in Alberta as we know it today was largely in place. This required tremendous investments in infrastructure in the form of roads, towns and pipelines. During this period, Albertans also enjoyed growing prosperity through the Crown's share – land sale bonuses from the leasing of mineral development rights and the royalties from production.

By 1957 – 50 years ago – there was more money coming into Alberta's treasury than the government believed it could prudently manage. So that year Edmonton chose to distribute 25% of Crown oil and gas resource income back to Albertans. In 1957, \$10 million was distributed to 500,000 Albertans over the age of 21 at the rate of \$20 per person (corrected for inflation using the Consumer Price Index, this would have been \$148 in 2006, the same year the \$400 cheques were distributed to Albertans by the province).

What is noteworthy about the 1950s and 1960s that has parallels with the oilsands today is Alberta was a net capital importer as it worked to transform itself into an oil and gas exporter. There was not enough money in Alberta or cashflow from production to pay for everything that needed to be built.

However, based on geological promise and a stable and profitable fiscal regime, funds flowed in from all over the world to develop our hydrocarbon resources.

What is extremely critical for this panel to remember is that the maximum Crown royalty during this period of capital-intensive development was 16 2/3%. This royalty rate appeared satisfactory to the government and public at that time, although it was significantly lower than the current royalty rates that are today alarming so many. Otherwise, I wouldn't be here today.

The purely administrative purpose of Alberta's Crown royalty regime served Albertans very well.

This all began to change in the early 1970s with the election Peter Lougheed's first Conservative government and the sharp escalation of world oil prices. What began was the politicization of Alberta's royalty regime, and the final results would prove disastrous.

A year after taking power in 1971, the base Crown royalty rate was raised by the Lougheed administration to 21%. At that time, however, the province was already

nervous about the redirection of capital from Alberta to Alaska following the massive discoveries at Prudhoe Bay in 1968. That oil development capital was mobile – that it could move around to opportunities elsewhere – was clear to the Alberta government over 25 years ago.

The biggest change in Crown royalties took place from 1973 onwards as oil prices continued to rise and the federal government began to intervene in Alberta's oil business. Ottawa imposed export taxes, set prices below international levels, and disallowed the deduction of Crown royalties from federal income taxes. A federal/provincial political battle over control of Alberta's resources began that would ultimately yield no winners.

Over the next few years the effective crown royalty tripled to as high as 50% on "old oil", crude from mature pools discovered prior to 1974. There was a lower royalty on "new oil" – that discovered after 1974 – as an incentive for oil companies to keep exploring. This was also accompanied by a series of activity-based royalty rebates that varied over the next 15 years.

However, in the 1970s continually rising oil prices and a varying degree of deductions and rebates disguised the negative impact of Alberta's massive royalty increases. Therefore, investment and development continued.

In 1973 Alberta also introduced a series of financial incentives to launch the Syncrude oilsands project. Billed at the time as a joint private/public initiative, Edmonton created a special royalty regime for this project and invested directly in the pipeline and power infrastructure through a new entity called the Alberta Energy Company jointly owned by the province and Albertans. I remind you that AEC, as it was known, is part of the highly successful EnCana Energy today.

At the time Premier Lougheed proudly announced that Syncrude could contribute a billion dollars in royalties over the next 25 years. From the time the project began producing in 1978; Syncrude has in fact contributed \$3.2 billion in Crown royalties and \$6.6 billion in taxes of all kinds.

Starting in the early 1970s, world oil markets were introduced for the first time to the influence of the Oil Producing and Exporting Countries, or OPEC. OPEC had enough production under its control that, acting collectively, it could influence prices. OPEC had a major influence on oil prices in the 1970s; however history has proven that OPEC's influence is overstated. More on that later.

In 1980, the federal government introduced the National Energy Program, today widely regarded as one of the worst pieces of public policy in Canadian history. A year later Alberta and Ottawa negotiated the Western Accord.

Based on the premise that oil prices would continue to rise forever, there appeared to enough money around for Alberta, Ottawa and the industry. Setting

public energy policy based on ever-rising oil prices that defied the fundamental market forces of supply and demand would prove to be an enormous mistake.

The belief in the late 1970s and early 1980s that oil prices would continue to rise confirms that energy policy analysts are extrapolators, and in fact have no clear or accurate view of the future. It is remarkable how many people in government in industry were dead wrong about oil prices 27 years ago. Because of this, one should be extremely cautious when predicting commodity prices today.

It was during the federal/provincial energy wars of the 1970s and 1980s that three political philosophies developed in Alberta that would shape the province to this day. These three political beliefs are today a significant driver behind these public hearings. They will be referred to in this presentation as the “Three Alberta Oil Myths”.

- 1) *Oil and gas resources are owned by the citizens of Alberta.* This was a politically convenient position for Mr. Lougheed so, based on large plurality in recent provincial elections; he could claim strong political support for his case in his jurisdictional battle with Ottawa. But it is not true, and never has been. In 1930 subsurface mineral resource administration was transferred from Ottawa to the provinces and remains there. But as a citizen of Alberta I can lay no direct claim to my share of Alberta’s resources, nor can I take it with me if I leave the province. As an Albertan I have no direct participation or ownership of hydrocarbons through the government any more than I can lay claim to my pro-rata share of the highways, hospitals or provincial legislature building. Albertans don’t know how to find, produce or market oil or gas. Alberta manages its hydrocarbon resources along with other shared public assets such as forestry, fish and wildlife, minerals and water. However, for some reason oil and gas receives special treatment to this day as those who speak about this specific resource commonly say “It is ours, therefore we must.....”. This right of ownership – in fact entitlement - is a common justification among those who criticize the current royalty regime. This is highly political argument that would ultimately prove very damaging to Alberta’s petroleum industry.
- 2) *Oil is a non-renewable resource and therefore the province must save money from oil produced today for future generations.* As Premier Lougheed collected more Crown royalties than Edmonton could spend and attempted to protect it from Ottawa, the Heritage Fund was created under the premise that Alberta would soon run out of oil and these funds would be then available for future generations. This was a highly political position and a major intervention in the economy from the purely administrative role of previous provincial administrations. In 1977 I recall being told by the government in a highly political way that Alberta only had 11 years of oil production left (please note that current levels of production are significantly higher than they were 30 years ago). Regardless, despite

record production levels, strong opinions exist today among critics of the current royalty regime that the Heritage Fund should be much larger than it is. This is a highly political use of Alberta's hydrocarbon administration obligations.

- 3) *The province should actively participate in the diversification of Alberta's economy.* All governments were more active in intervening directly in the economy in the 1970s than they are today. Starting in the 1970s Alberta used oil money and public policy to undertake a number of economic diversification strategies with varying degrees of success based on aforementioned premises 1 and 2. Collecting higher oil and gas revenues and redirecting them to other sectors of the economy is a highly political initiative and, based on the success of Canadian governments in the past, a highly risky endeavor. That the Alberta government should lead the charge in industrial diversification and therefore collect as much oil and gas income as possible today so that it can provide capital and be an agent of change when the hydrocarbons run out is a popular and highly political subject that has led to this public royalty review process.

During the early 1980s, drilling and development activity continued because of significant cash rebates from Ottawa through the NEP and the continued but increasingly complex series of incentives from Alberta.

However, by 1985 the party was over with the collapse of world oil prices. Within a year the National Energy Program was largely disbanded.

It is remarkable that during the period of rising oil prices from 1973 to the creation of the NEP, the fundamental market forces of supply and demand were forgotten. The oil price shocks of the 1970s caused significant changes to global oil consumption patterns and high prices spurred exploration for new sources all over the world. Soon oil supply far outstripped demand and it was only armed conflict in the Middle East and supply management by Saudi Arabia that kept oil prices from declining much sooner than they did.

The oil price collapse of 1985 exposed the fundamental weakness of OPEC. OPEC functions best when supply and demand are in balance and OPEC becomes increasingly ineffective as total supply exceeds total demand. In the early 1980s, OPEC's growing production surplus was disguised by the Iran/Iraq war. OPEC's ability to hold oil prices high was due to Saudi Arabia acting as the "swing producer" and shutting in oil to mop up worldwide surpluses and cover the refusal of other OPEC members to work within their pro-rata OPEC quota.

When Saudi Arabia abandoned its role as OPEC's swing producer in 1985, world oil prices collapsed and would not rise to any great degree until worldwide supply and demand narrowed early in the 21<sup>st</sup> century.

In 1986 OPEC was able to stabilize prices at \$US18, but only after 11 million barrels a day of production were shut in (OPEC had total capacity of 27 million b/d and agreed upon 16 million b/d as the output that would stabilize oil prices). This massive oversupply would hang over the market for the next 18 years. OPEC attempted to manage supply but the diverse nature and objectives of its members would make this very difficult. Because of this surplus, oil prices remained low and volatile until early in the 21<sup>st</sup> century.

Against the backdrop of the National Energy Program and the world oil price collapse, it would be several years before the Alberta government realized that it had gone much too far with its royalty increases under the new and sobering realities for world oil prices. While the NEP and falling oil prices still receive most of the blame for the collapse in Alberta that followed the boom, Alberta's excessive Crown royalties cannot not be ignored as a major contributor.

The 1980s were a brutal period of readjustment for Albertans. The end of boom of the 1970s precipitated the collapse of many companies, real estate prices and even two new Alberta-based banks. Gas prices also collapsed. By 1990 they were so low that one American sage commented, "The say that natural gas is the fuel of the future. It must be because it has no present value".

During the 1970s and the early 1980s, the size and role of the Alberta government grew enormously based on its new found income stream from higher Crown royalties. After oil prices collapsed in 1985 and the Crown royalty share fell in kind, Edmonton turned to deficit financing for the first time in decades in order to continue to fund a massive growth in government spending.

The Three Alberta Oil Myths had proven to be based on false premises.

- 1) Oil and gas clearly wasn't owned by Albertans because it required an active and profitable oil industry to develop these resources. There were lots of hydrocarbons left to be developed but development had stalled. Alberta's oil resources were worthless without an active and profitable private sector to exploit them.
- 2) While oil was still viewed as a non-renewable resource, whatever money Alberta had saved for rainy day was inadequate to finance the non-development monsoon. Provincial savings would never replace the revenue generated by exploration, development and production.
- 3) Many of the industrial diversification initiatives undertaken during the 1970s and 1980s had proved disastrous. Turning to provincially mandated, politically-driven, non-petroleum economic development a source of future industry, employment and taxes wasn't working, nor was it likely to work.

The industry lobbied hard for Alberta to cut royalties to improve development economics in the late 1980s and early 1990s but was consistently told this was impossible for the following reasons:

- 1) The province was running a deficit.
- 2) The Three Alberta Oil Myths lived on.
- 3) It would be politically unpopular.

Meanwhile, the industry struggled desperately. Drilling of new wells declined steadily to the point that by 1992 only 3,759 new wells were drilled in Alberta, down by half from earlier years. This compares to 16,911 in 2005 and 16,687 in 2006.

Finally in 1991 the Province of Alberta had to face the following realities.

- 1) Oil and gas prices were down and weren't likely to rise.
- 2) While Albertans may have been told that the province's oil and gas was "theirs", it wasn't of much value unless it was exploited.
- 3) The Heritage Fund wasn't going to solve the long term needs of Albertans.
- 4) Provincially directed and petroleum industry funded industrial and economic diversification was not successful, and in some cases spectacularly unsuccessful.
- 5) Ottawa was no longer the problem, and in fact the federal government had offered the oil industry a tremendous boost through the greatly improved natural gas export provisions of the 1998 Free Trade Agreement.
- 6) The only tool left to get the oil industry back on its feet was reductions in Alberta's punitive Crown royalty structure, a hangover from a boom that had ended a decade earlier.

If Alberta's petroleum resource management process is allowed to again become politicized as it has been in the past, I assure you that we're going to repeat the mistakes of the past.

### **THE PRESENT: 1991 – 2006**

#### **A return to provincial resource administration yields spectacular results**

*"Don't it always seem to go that you don't know what you've got 'til it's gone"* – From Big Yellow Taxi, re-recorded by Joni Mitchell, 1975

In 1991 Alberta introduced a new royalty regime for conventional oil and gas that remains largely unchanged. In doing so the province returned to a more administration-oriented role and largely removed itself from using Crown royalties for political purposes. The hodge-podge of incentives and rebates was replaced with a simpler system that reduced the Crown's take substantially in the short term but over time would prove highly successful for the Crown and the petroleum industry.

By 1993 the economics of development had improved to the point that the drillers went back to work. Even though prices for oil and gas remained flat, that year the industry drilled 6,879 new wells in Alberta. The number of gas wells compared to oil wells began to increase in the 1990s to the point that in 1998 new gas wells outpaced new oil wells for the first time. That pattern continues today.

In 1993 another major change took place in Alberta on the political front. Ralph Klein was elected premier and began what would later be known as the Klein revolution. He was elected on a platform of cutting costs and that he did. Over the next few years he undid much of the growth in the provincial government and provincial spending that had taken place in the previous 20 years.

To get back on its feet in the 1990s, Alberta had to take a two-pronged approach: reduce its Crown royalty take to create the economic incentive for the petroleum industry to begin growing again, and reduce public spending that had mushroomed out of control based on what history would prove was a short-term spike in revenues from existing oil and gas production.

The last major initiative of the 1990s was to create a fiscal regime to develop the massive but yet scarcely tapped resource potential of the oilsands. Therefore, Alberta introduced a new and attractive fiscal regime for oilsands development whereby a nominal 1% royalty on new projects would be levied until payout or capital recovery, followed by a 25% royalty on profits thereafter.

What followed the 1991 conventional oil and gas royalty review, the 1996 oilsands royalty changes, and the 1993 Klein spending reduction revolution, was 15 years of growth and unprecedented prosperity. While Klein's cuts in the size and scope of government were painful at the time, his government would later be regarded locally and nationally as visionary.

Following the tragic events of 9/11, there was a dip in the price of oil in 2002. However, later that year the oil industry began to turn around and what followed in 2003 through 2006 was a period of unprecedented prosperity. It is safe to say that Alberta enjoyed an oil boom that rivaled that of the 1970s. The basis of the 2003 to 2006 oil boom is summarized as follows:

- 1) A sound, profitable and attractive royalty, administrative and fiscal regime for oil and gas development, particularly the oilsands.
- 2) The perception that the Alberta government would provide an attractive and predictable fiscal environment for long-term investments, particularly important for the oilsands that required massive capital investment and long-term stability.
- 3) Rising oil and gas prices.
- 4) The Three Alberta Oil Myths had been forgotten as Alberta largely abandoned using oil and gas revenues for political purposes.

Concurrent with the growth of hydrocarbon production and proceeds to the Alberta treasury from 1991 to 2006, there was in growth in other areas. These are very significant but are not always discussed. They are:

- 1) The growth in Alberta's oil service industry. While the Canadian content of oil service has grown since the 1950s, in the 1990s it reached its zenith. Alberta's oil service industry gained international recognition as a capable supplier of knowledge, equipment and services. The service sector grew to the point that it began to develop a significant export component. Today, Alberta's oil service sector is much larger than is needed to support Alberta's requirements alone. The oil service sector exports knowledge and imports profits on a global scale, yet its total impact on Alberta's economy is rarely mentioned and certainly not understood. The oil service sector also supports significant industrial manufacturing and support industries that are a significant and successful – but scarcely mentioned – source of industrial diversification and secondary industry in Alberta.
- 2) Calgary's emergence as a major financial centre. The growth of Alberta's oil industry is only part of Calgary's emergence as a major, western centre for financial and technology on a global scale. Calgary based oil and service companies operate all over the world, not just Alberta. Many head offices have also relocated to Calgary to exploit the growing financial and technological support base. Many Alberta-based E&P companies are global in scope and are successful all over the world using knowledge and expertise from Alberta.
- 3) Significant growth in Alberta's corporate and personal tax base. Because of the growth in Alberta's oil and gas production industry, Alberta's increasingly international service industry, Calgary's emergence as a corporate head office centre, and the growth in population, the Alberta government now receives a much higher proportion of its annual revenues from corporate and personal income taxes. This is more evidence that a robust private sector can ultimately yield greater rewards for the provincial government than the raw rate of Crown royalty collection.

By late 2005 and early 2006 the oil boom had reached the point that Albertans faced a new set of problems from the 1980s – coping with runaway growth. The problems manifested themselves in overtaxed public services in areas like education and health care, housing, labor shortages and a lack of physical infrastructure like roads (example - the highway from Edmonton to Fort McMurray).

However, Alberta's confidence in "supply side" economics paid off handsomely. In 2005, for example, Edmonton received a staggering \$14.3 billion in total direct revenues from mineral license bonuses and production royalties plus billions more in personal and corporate incomes taxes from the robust private sector.

This was the highest amount of revenue the province had ever received from petroleum resources, a remarkable accomplishment considering a perceived finite supply of non-renewable resources that had gained political and public traction in the 1970s and Crown royalties that many commentators today believe are too low.

What helped precipitate the short lived boom of the early 21st century was that for the first time in 30 years, world oil demand and supply were largely in balance. OPEC was successful because it had virtually no spare production. OPEC production quotas were largely ignored since the production capacity of some OPEC members like Indonesia was actually lower than its quota. Internal strife in Iraq and Nigeria depressed their productive capacity.

Ignoring the lessons of history (the impact of commodity prices on supply and demand) that world oil markets taught us so painfully twenty years earlier, more people embraced the “Peak Oil” theory – that the world’s productive capacity had peaked and oil prices would only affect demand, not supply because supply had peaked regardless of investment and technology.

As for demand it would continue to grow because oil could not be replaced as a transportation fuel and the booming economies like China and India would increase oil demand regardless of price.

In Alberta, rampant prosperity was somehow accompanied by rampant envy. During this period major oil producers enjoyed record earnings. You’d think more people would regard this as a good thing, but an historic and latent distrust of oil companies lingers. Although not all of those profits were earned in Alberta, the high profits of the producing companies attracted significant attention.

So despite the massive amounts of money flowing into provincial coffers and the unprecedented prosperity enjoyed by most individual Albertans, the perception emerged that the Alberta government was not getting its “fair share” as the representative of the “owners” of the resources, the people of Alberta.

More people and organizations began to pressure Edmonton to again use the royalty system for political purposes.

Comparisons to places like Norway and Alaska emerged, even though they are geologically quite diverse and have different tax structures (remember that Alberta only administers Crown mineral rights, not the federal income tax regime).

Oil company profits attracted significant attention. Even though most of the E&P companies reporting record profits have some or most of their operations outside of Alberta, these earnings were seen as “obscene” and therefore justified higher Crown royalties.

Complaints about a lack of infrastructure in the form of hospitals, schools roads and affordable housing emerged, and continue today. The belief was that if Crown royalties were higher, then somehow these problems would go away.

Revenue sharing between provincial and municipal governments is a political issue across Canada and most of the developed world, not just Alberta. Our province has adequate funding for infrastructure projects from existing oil and gas revenues. How these funds are spread around the province has nothing whatsoever to do with the Crown royalty regime.

(Had the Alberta government invested heavily in infrastructure in the past few years, this would have only further overheated the provincial economy as road, school and highway construction competed with the private sector for labor and housing. Every growth-related problem Alberta has had in the past few years would only have been worse had Edmonton spent heavily alongside the private sector).

Opposition political parties, looking for an issue on which to attack the government, seized upon the Crown royalty regime as an example of mismanagement justifying a change in government.

Environmental lobby groups, concerned about the rapid development of the oilsands and industrial emissions, began to criticize the Crown royalty system knowing that if royalties were increased then the pace of development would slow or possibly stop.

The three Alberta Oil Myths re-emerged . Our non-renewable resources were being mismanaged. The Heritage Fund must be larger. The Alberta government must accumulate piles of money today so when the oil and gas runs out, we can all go to work for some sort of provincially funded or managed non-petroleum industry.

These concerns that the Crown royalty rate was too low – that an Alberta government collecting billions on oil revenue was not getting its fair share – became a political issue during last year’s Conservative party leadership race. (That Albertans were not getting their “fair share” is a bizarre conclusion considering the greatest beneficiaries of the oil boom were Albertans themselves).

The oilsands boom has become a peculiar magnet for this malcontent. The reason I say “peculiar” is because the spectacular expansion of oilsands development and the pressures it has placed on the provincial workforce - and the community of Fort McMurray - are not based on profits or production, but investment in facilities and capital assets for future production and potential profits.

While Syncrude, Suncor and a couple of others are producing oil, most of the spending and pressure is being created by the construction of new oilsands plants.

Let's put a few facts in order.

- 1) People have been trying to make money from the oilsands for 100 years.
- 2) The economic environment to develop the oilsands commercially that took place in the 1970s was due to a large spike in oil prices and the introduction of an attractive fiscal regime by governments including direct government participation.
- 3) Profitable commercial production only began in the 1990s after oil prices stabilized and Syncrude and Suncor were able to continually reduce their operating costs.
- 4) In 1996 the Alberta government introduced a new fiscal regime – the one we have today – to foster more growth. It worked.
- 5) The rise in oil prices from 2003 onwards, combined with Alberta's royalty regime, accelerated interest.
- 6) Capital began to pour in from all over the world to develop new oilsands production. This is the first time this has happened to Alberta since the 1950s and 1960s because a) the oil is in Alberta and b) because an attractive fiscal regime was in place.
- 7) The boom in spending in the Fort McMurray area in the past few years is not from existing production, but from companies investing billions in the hope that they might some day produce oil and earn a profit.
- 8) The majority of the Crown land sale lease bonuses and production royalties flowing to the Alberta government are not from the oilsands or oilsands developers, but from existing production.
- 9) Although it does receive significant Crown royalties from the oilsands, Alberta government has collected corporate and personal income tax from companies and workers involved in oilsands construction.
- 10) Once these new oilsands projects under construction are on stream and have passed through the capital recovery stage, they will pay higher royalties and then will contribute to Alberta's total Crown royalty income.
- 11) Little of the so-called "windfall" profits that oil companies have reported in the past few years have come from oilsands production. In fact, these companies are diverting profits from all over the world into the oilsands on the premise that profits will eventually emerge.

What the oilsands really are in 2007 is a financial black hole in the hope of producing black gold. But somehow the idea has emerged that the industry is profiteering at the expense of Albertans. A major focus of the Alberta public royalty review process will be the oilsands.

The attempt to re-politicize the administration of Alberta's hydrocarbon resources is a large reason we are here today. I urge the panelists and other studying this

subject and think this through. Because, as Joni Mitchell sang, “You don’t know what you’ve got ‘til it’s gone”.

## **THE FUTURE: 2007 and Beyond**

### **Attempts to use public resource administration for political purposes will fail as they have in the past**

*“The Stone Age didn’t end because we ran out of stones. The Oil Age will not end because we run out of oil” – Sheikh Zaki Yamani while Oil Minister for Saudi Arabia during the 1970s and 1980s*

As I have attempted to prove in this presentation, today’s Alberta’s Crown royalty structure has been evolving for many years.

First we got it right, and Alberta’s oil and gas industry was born when Alberta simply managed the process.

Then, based on the phantom economics of the 1970s, we got it terribly wrong when political agendas became more important than orderly administration.

Finally, after a decade of suffering in the 1980s, we got it right again in the 1990s when Edmonton retreated to resource administration and quit using the petroleum industry for political purposes.

I fear that if we don’t take history and our past mistakes into consideration, we’re being driven by seemingly well intentioned but ultimately dangerous political pressure to screw it up once again.

If you look at Alberta’s royalty regime from the view of all stakeholders, it is a stroke of genius in its current form and therefore should not be changed.

It is highly participatory by all Albertans who choose to do so. Whether it be direct or indirect share ownership of the oil producing companies; direct or indirect employment in the petroleum industry; the development and growth of a large and vibrant support industry with export potential in oil service; or the Alberta advantage of the lowest personal and corporate tax rates in Canada; the current split between the government and private sector should serve as model for oil producing regimes around the world.

Yet the reason this panel exists at all is because the critics of the existing royalty regime are only looking at two small components of the entire process: oil producing company profits and the Alberta’s government’s average royalty rate.

Comparisons with other jurisdictions like Norway, Texas or Alaska are interesting but when all factors such as the nature of the production, the capital cost, and

other taxes the managing government receives from companies and workers, they are largely irrelevant. The focus of this panel should be on the needs of all Albertans, not the people of other countries.

Ignored are the facts that I have been trying to present today, which I will summarize again for clarity.

- 1) The oil companies that operate in Alberta today are, with but a few exceptions, broadly owned. To focus on the profits of Exxon-Mobil or EnCana and not take a moment to understand the millions of beneficiaries – many of whom are Albertan – is utterly simplistic.
- 2) The vast majority of the people employed by companies developing hydrocarbon resources in Alberta are Albertans. This is particularly true of the oil service sector. Every dollar diverted from oil company spending in Alberta to the province is ultimately taken out of the pockets of working and investing Albertans.
- 3) There exists a major direct Alberta oil service support industry that is larger than Alberta's requirements, and that industry imports wealth from all over the world as it expands. This would not exist if an appropriate public/private sector revenue split had not existed in Alberta for most of the past 60 years (post-Leduc).
- 4) There exists an even larger indirect support industry that is entirely Albertan. This includes auto and truck dealers, hotels, restaurants, communication companies and the myriad of other support business required to feed, cloth and house oil workers.
- 5) The foundations of Alberta's oil industry were developed at a Crown royalty share lower than today. Alberta has raised royalties in the past and, when commodity prices corrected, they have been reduced to keep the industry alive.
- 6) Past attempts to use petroleum revenues for political purposes have not worked. Alberta has done best when the province administers resources and does not use these resources for political purposes.
- 7) With the exception of Syncrude and Suncor which date back to the 1970s, no oil and gas companies are currently making any money as they develop new sources of production from the oilsands. These companies are investing heavily, yet the perception is that they are profiteering and therefore must be penalized. This is not fair and a negative change would cause significant long-term damage to Alberta's reputation for political stability and fiscal fairness.

Another factor precipitating this royalty review is that the high oil and gas prices Alberta has enjoyed in the past few years are permanent. To believe this and modify Alberta's royalty regime accordingly would be a big mistake. Despite the belief in "Peak Oil" and that commodity markets are no longer relevant for oil, recent events would indicate otherwise.

While OPEC may have been unable to produce more oil as recently as early 2006, it is frightening how quickly high prices have affected supply and demand. Many factors have increased the price of oil in the past few years have nothing to do with “Peak Oil” or supply and demand. Several other factors will temper oil demand going forward which will also keep world oil prices in check. These include:

- 1) Falling production in Mexico, Venezuela, Iran, Iraq and Nigeria due to political factors. There’s lots of oil to develop in each of these countries should these countries stabilize or accept foreign capital.
- 2) Barriers to investment in other major oil producing regions such as Russia and Saudi Arabia.
- 3) Abnormal weather patterns such as Hurricane Katrina.
- 4) Flat or falling demand in industrialized countries due to high prices.
- 5) Forced demand reduction caused by environmental forces related to the belief that burning hydrocarbons is a large contributor to global warming.

OPEC is currently at a crossroads. As recently as May 2, OPEC ministers were concerned about growing momentum in the world’s largest oil consuming countries to reduce consumption. The US alone is determined to reduce gasoline consumption by 20% in the next 10 years.

Meanwhile, Saudi Arabia is investing heavily to increase production to record levels. That nation now has excess production capacity exceeding 2 million b/d when a year ago it had virtually none. This is being repeated all over the world as new non-OPEC producing regions such as Africa yield measurable new increases in production.

It is safe to say that were all political forces removed from world oil markets – were there an outbreak of global peace and all oil producing countries opened their borders to private capital and expertise – oil production were rise dramatically in a short period of time and current oil prices would collapse.

Hoping for continued political strife and misery and the gross mismanagement of hydrocarbon resources by state oil companies is hardly a sound foundation for Alberta’s future energy policies.

No oil producing area in the world would suffer more from dramatically lower oil prices than Alberta with its increasingly marginal conventional production and its high cost, non-conventional oilsands production.

To base our future energy policies and royalty regimes on world oil prices that have repeatedly proven to go down after each and every time they rise would be a serious and regrettable mistake.

As the royalty review panel hears presentations from myself and others and moves towards a final report, what your final conclusion will really boil down to is this: What is the ideal role of the Alberta government in the continued development of hydrocarbons resources? Should the province continue with its proven successful administrative role, or should the province again use petroleum as a political tool for other objectives?

Let's again review and hopefully dismiss the Three Alberta Oil Myths that have clouded our public energy policy debate for three decades.

- 1) *Oil and gas resources are owned by the citizens of Alberta.* The Alberta government is trusted with administering Crown mineral rights, much in the same way they administer the highways, schools, and the health care system. The Alberta government has never found any oil. Oil companies and their oil service support companies find oil. Oil in the ground is of no value. Until the oil companies found it, Alberta didn't even know it existed. The people of Alberta cannot find and develop oil. All they can do is hope their government will create a fiscal regime that will allow those who can find oil to do their jobs. The only potential for direct ownership of oil by Albertans is through the oil companies that develop it, not through the government. By allowing the myth that Albertans own the oil to continue, then oil company profits are unfairly characterized as wealth taken from Albertans. Nothing could be further from the truth. Oil company profits are created by oil companies and their investors. As the administrator of Crown mineral rights, it is up to the Alberta government to create a fiscal regime that benefits the most people including the people of Alberta. As I have stated earlier, Alberta – through trial and error – has created that balance. Changing it would be a huge mistake.
- 2) *Oil is a non-renewable resource and therefore the province must save money from oil produced today for future generations.* The idea that the world and Alberta are running out of oil rears its head periodically then disappears as market forces prove otherwise. The oil panic of the 1970s was replaced by a twenty year glut as high prices created conservation and the development of new supplies. In the past three years the "Peak Oil" myth has again emerged, but recent market forces are also bringing this theory into doubt as new supplies emerge and governments begin to force conservation because of growing environmental concerns that burning oil is harmfully changing the Earth's climate. The largest single oil deposit in the world – the oilsands – is in Alberta. The highest level of recovery from any oilfield ever discovered in Alberta is about 50%. Over 70% of all the conventional oil ever discovered in Alberta is still in the ground awaiting recovery through the development of new technologies or an improved fiscal regime. Alberta will never run out of oil while it still has any commercial value to mankind. Therefore, this panel must seriously reconsider the idea – the myth - that the Alberta must collect and hoard oil money today for future generations. Should Alberta ensure the

continuation of a vibrant private sector through a balanced Crown royalty regime that reflects the unpredictability of oil and gas prices, then that private sector will work hard to develop the technologies to continue to find ways to find and recover more oil in ways and places we have not yet discovered. The world is not running out of oil, but cheap oil is in diminishing supply largely for political reasons. Should oil prices stay the same or rise, the economic incentive to squeeze more of Alberta's known and unknown reservoirs and reserves will ensure our industry continues for generations.

- 3) *The province should actively participate in the diversification of Alberta's economy.* One of the justifications for raising Crown royalties and expanding the Heritage Fund is so that the Alberta government can either provide funding or act as a catalyst for the growth of new, non-petroleum industries. Ignoring the litany of disastrous attempts at industrial diversification by Alberta and other governments in Canada and around the world, the notion that Albertans must depend upon the government to ensure their economic future seems incredibly un-Albertan to me. We regard ourselves as a very entrepreneurial breed that combines capital and ingenuity to create opportunity, employment and wealth. The idea that we must look to the province for our economic future means that Alberta's entrepreneurship is just another hydrocarbon by-product like motor oil or gasoline. What must be considered as this panel ponders its recommendations is; what could a vibrant private sector do on its own if it had the capital? If the Alberta government ends up with an unfair share of the money from oil production today, the best and brightest will most surely leave this province to seek and create opportunities elsewhere. Those who stay will indeed need government support. Tragically, in the alleged Canadian capital of free enterprise, there is very little confidence in the current public debate that the people best qualified to take care of the future of Albertans are Albertans themselves.

To me, following are the main questions that must be asked. Answers are provided.

- Should Alberta's Crown royalty system be used to control oil company profits? No. That is the job for the tax system and the public capital markets, not the provincial government or resource development administration.
- Should Alberta's Crown royalty system be used to divert funds from successful industries like petroleum to other industries selected by the provincial government? No. That is not the role of the province and will only lead to the repeat of past failures.

- Should Alberta's Crown royalty system be used to control the pace of development for environmental and social reasons? No. These are policy issues that should be dealt with by other government departments.
- Should Alberta's Crown royalty system be used to change provincial/municipal funding arrangements? No. This has nothing to do with orderly and profitable resource development, and the province has adequate funds should this become a priority.
- Should Alberta's Crown royalty system be used to penalize the financial well-being of the petroleum industry and Albertans today so the government can subsidize our citizens at some point in the future? No. Alberta will be in the oil and gas producing business so long as these commodities have commercial value.
- Should Alberta's Crown royalty system be hijacked by opposition political parties for their own gain, which is not necessarily congruent with that of Albertans? No. Check with Hugo Chavez in Venezuela to remind yourself how quickly this process can spin out of control.

Increases to Alberta's Crown royalty take will ultimately hurt my company, our employees, their families, our shareholders, my friends and my fellow Albertans. This is the clear lesson from history.

This panel must ensure that the Alberta public resource administration process in our province is not allowed to become politicized.

On behalf of my fellow Albertans who have punished by the mistakes of the past, and on behalf of my co-workers at HSE and their families, I plead with you to leave Alberta's royalty regime alone and be confident that if you do, our prosperity will continue for generations to come.

Thank you.

A handwritten signature in black ink, appearing to read 'D. Yager', with a stylized, cursive script.

David L. Yager  
Chairman and CEO  
HSE Integrated Ltd.  
Calgary

## Appendix 1

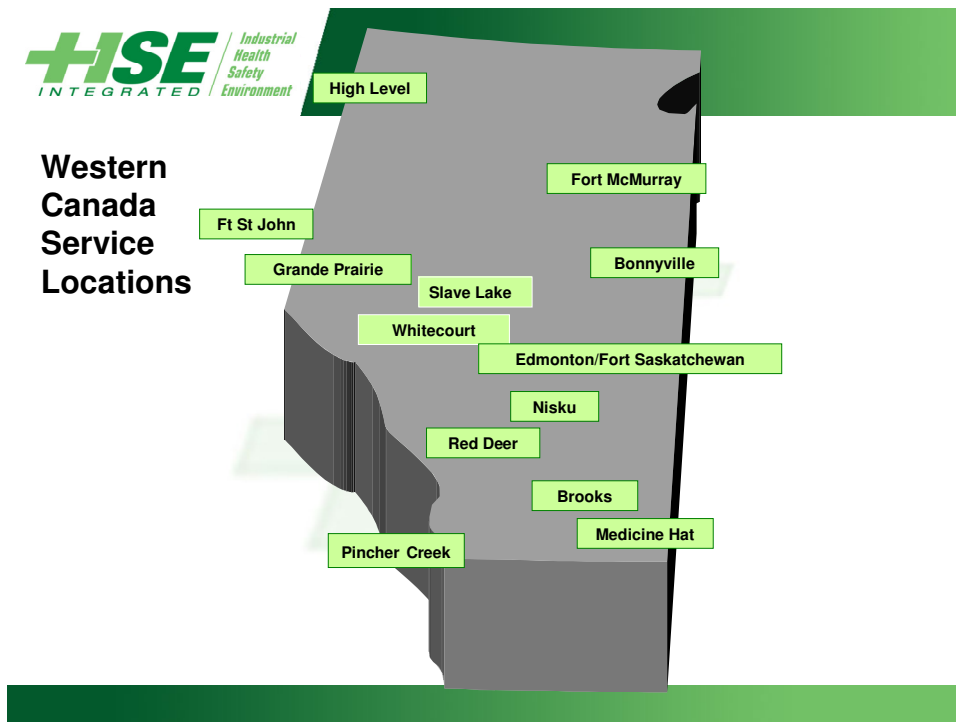


### HSE Integrated Ltd.

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### About HSE

HSE is Canada's largest and only national supplier of Health, Safety and Environment Services for industry. Our mission is to provide industry with quality, cost-effective products and services to protect workers, assets and the community. HSE has 650 employees operating from 16 locations across Canada. Over 500 workers and the majority of those locations are in Alberta. HSE's largest client is the oil and gas industry which comprised about 90% of total revenues in 2006. HSE is publicly traded on the TSX Venture Exchange.



## History

Today's HSE is comprised of 18 private companies (15 from Alberta) that have been brought together into a single entity with greater capacity and resources than existed before. HSE specializes in providing safety services for the petroleum industry from exploration and development through to refining and marketing. Most of these companies were created in response to the unique safety needs of hydrocarbon development in Alberta, particularly poisonous hydrogen sulphide gas. Some of HSE's corporate roots date back to the 1950s.

## Services Provided



### Detailed Services Summary

#### HEALTH

- Onsite First Aid – Mobile
- Onsite First Aid - Fixed
- Industrial Ambulance
- Audiometric Testing
- Drug and Alcohol Testing
- First Aid Training
- Industrial Hygiene Services

#### SAFETY

- Breathing Air Equipment and Services
- Fire Protection and Control
- Decontamination
- Gas Detection Equipment
- Safety Supervision
- Shutdown and Turnaround Services and Crews
- Confined Space Entry and Rescue
- High Angle Rescue
- Complete Safety Training Services

#### ENVIRONMENT

- CARMEN-REACTOR Advanced Stationary Air Quality Monitoring System
- Mobile Downwind Air Quality Monitoring
- Plume Dispersion Modeling
- Noise Testing
- Large Volume Storage Tank Cleaning
- Airborne Hydrocarbon Neutralization
- Hydrocarbon Spill Neutralization

## Future Plans

HSE's roots in Alberta's petroleum provide an excellent foundation for national and international growth.

Alberta's belief in a strong and profitable private sector have allowed the Alberta government to introduce some of the most stringent worker and community safety and protection regulations in the world. These regulations, plus the diverse operating conditions in Alberta, have required the development of unique and highly specialized services that are widely respected and required by other industries.

For example, air quality monitoring technologies developed for hydrogen sulphide gas in Alberta have excellent applications in other industries and will provide HSE with an excellent technical platform to expand its services to assist industry in complying with new stringent regulations related to greenhouse gases.

HSE is confident that so long as it is able to maintain a strong and profitable base of operations in Alberta, it will be able to continue to expand to other industries and other markets and become yet another Alberta success story that was launched by the petroleum industry.

## Appendix 2

### **CV – David Lenard Yager**

Calgary, Alberta

#### **OVERVIEW**

David Yager, 53, has extensive management, business development and communication skills to help companies grow, create shareholder value, assist investors in the strategic deployment of capital to yield optimal returns, and explain the significance of new and complex concepts and ideas. In his career he has unique experience in the development and commercialization of new oilfield service products and technologies and substantial experience in private company acquisition and consolidation strategies. He has also been an active public commentator on politics and energy policy since 1979.

#### **CURRENT**

##### **Chairman CEO, HSE Integrated Ltd.**

HSE Integrated Ltd. is a public, integrated industrial safety services company listed on the TSX Venture Exchange under the symbol “HSL”. In October 2003 he led a refinancing and restructuring of Patch Safety Services Ltd. that included a \$2.4 million equity injection. A new senior management team and Board of Directors were put in place at that time. His present mandate is to build the company in the national and eventually international industrial Health, Safety and Environment sectors. In the past 27 months HSE has completed 16 acquisitions and invested over \$60 million in expansion to become the largest industrial safety services in Canada and the largest oilfield safety services company in the world. HSE has 650 employees across Canada, revenues of exceeding \$100 million in 2006, and is industry’s first national safety services company.

#### **1994 - 2002**

##### **Integrated Production Services Ltd. - President, Founder, Director**

Integrated Production Services Ltd. (IPS) was a public company listed on the Toronto Stock Exchange before it was taken private in July, 2002. In 1994 Mr. Yager incorporated a predecessor company of IPS that was merged into IPS in 2000. As a consolidation play, IPS involved over 25 focused acquisitions involved in wireline, testing, production optimization, artificial lift, manufacturing and international operations. With IPS Mr. Yager articulated an oilfield service response to the squeezed economics facing its E&P company clients as finding and development costs increase with the maturity of the Western Canadian Sedimentary Basin. IPS is now part of Complete Production Services, Inc. which trades on NYSE with a market capitalization of \$US1.7 billion.

#### **1987- 1994**

##### **Tesco Corporation - Senior Officer, Founder, Director**

Starting with JCP Forewest Industries Ltd. in 1987, Mr. Yager helped create Tesco through the merger of three public companies and an equity financing in 1993. He recognized and defined the Tesco Portable Top Drive Rental/Service business opportunity that Tesco is noted for and was instrumental in sales, development and growth of this new technology. Tesco trades on TSX and NASDAQ with a market

capitalization of \$1.2 billion and is a global supplier of specialized drilling equipment and technology.

### **1979 – 1992**

#### **The Roughneck Magazine - Co-Owner, Publisher, Editor**

*The Roughneck*, an oilfield trade magazine, was purchased by Mr. Yager and a partner in 1979. Working as a combination businessman and journalist, Mr. Yager studied and analyzed the upstream petroleum industry from a unique position. Because of this experience, Mr. Yager has a broad perspective and understanding of the many diverse aspects of the large and complex oil and gas industry.

### **1970 – 1979**

#### **Diversified Oilfield Services**

Along with 2.5 years in various studies at the University of Alberta, during this period Mr. Yager worked on the drilling rigs rising to the position of derrickman, serviced oilfield equipment and downhole tools, trained as a fishing tool operators, and worked in Calgary sales for a company that is now part of Weatherford.

### **BUSINESS EXPERIENCE**

During his career as an oilfield service executive, Mr. Yager has been involved in two IPOs, two public company mergers, two unsolicited takeover offers (both sides), over \$100 million in equity and debt financings, and has personally undertaken about over 30 acquisitions of private companies, assets and technologies.

Mr. Yager is familiar with all facets of service company management and operations including corporate finance, due diligence, mergers and acquisitions, field operations, new technology, patents and intellectual property, sales, marketing, investor relations, advertising, business development, safety and environmental issues, market studies, competitive analysis, and human resources.

### **TECHNOLOGY EXPERIENCE**

Mr. Yager has been involved in the financing and commercialization of numerous technological development and/or improvements, primarily the areas of wellbore construction, completion and production. He is familiar with intellectual property issues, patents and patent procedures.

### **COMMUNICATIONS EXPERIENCE**

Since 1979 Mr. Yager has done significant freelance commentary on the petroleum industry and business and political issues for CBC Radio, CBC Television and other electronic media outlets. He has been an editorial columnist for the *Calgary Herald* and *Calgary Sun* newspapers and is currently an editorial columnist for *Oilweek*. He has been actively involved in analyzing federal and provincial energy policy and its impact on the petroleum industry since 1980. He is regularly consulted by the media on the upstream petroleum industry.