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Who's making money on natural gas prices?

By Fred Wilson

Canadian Centre for Policy Alternatives BC Office

1400–207 W. Hastings St
Vancouver, BC V6B 1H7
Tel: 604-801-5121
Fax: 604-801-5122
info@bcpolicyalternatives.org
www.policyalternatives.ca

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To arrange an interview with Fred Wilson, call Shannon Daub at 604-801-5121.

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Baby its' cold outside, and natural gas is expensive. Homeowner prices for the average British Columbia have increased by over 50% in the past six months, and there may be further large increases on the way.[1] The questions that many want answered are: where is all that money going? And who, if anyone, can or should do something about high natural gas prices?

The gas distribution companies and the natural gas producers unanimously insist that it is the provincial government that should provide relief to consumers by giving back some of the hefty royalties it is currently collecting. These royalties, of course, are the dividends that are owing to all British Columbians, who remain the collective owners of the natural gas in this province. Provincial royalties are "price sensitive," meaning that the higher the price, the higher the percentage royalty. Currently royalties are about 25% of prices. The BC government reports that in the fiscal year 2000/01 it is expecting to realize about $1 billion in royalties from BC natural gas production, three times the $335 million that was expected in last year's provincial budget.

The province's gain has certainly put it in a position to spend dollars that it would not have except for natural gas revenues. However, the province's royalty gains are not the cause of high consumer prices. Unlike consumer taxes at gasoline pumps, lowering these natural gas royalties would not reduce consumer prices. The royalty charged by the province is a percentage of the wholesale price set by the producer at the wellhead based on supply and demand in the North American continental market. If the royalty was reduced, or eliminated, the producer price would be unchanged.

Curiously absent from public scrutiny, however, are the natural gas producers themselves who are the greatest beneficiaries of the hot continental market in natural gas. The top ten producers in BC pumped 8.2 million thousand cubic meters of gas in 2000—about a third of BC's total production. These top 10 BC producer companies alone stand to generate over $1 billion in profits from natural gas at the prices predicted for the next year, and possibly much more. This will represent an increase of more than 25% over the past year. (This profit margin is before tax, and not including head office administrative

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Top 10 BC gas producers: production and estimated profits			
Company	Global corporate net earnings for first 9 months of 2000 ($ millions)[1]	Raw gas produced in BC 2000 (1000M^3)[2]	Estimated 2001 profit from BC natural gas production at $5.55 per mcf ($ millions)[3]
Canadian Natural Resources	$558	1,492,938	$187.2
Petro Canada	$507	1,460,463	$183.1
Talisman Energy	$621	992,055	$124.4
Mobil	$12,500 [4]	788,920	$98.9
Canadian Hunter	$94.5	679,572	$85.2
Anderson Exploration	$314 [5]	675,386	$84.7
Burlington Resources	$371 [6]	626,238	$78.5
Domcan Boundary	n/a	574,010	$72.0
Husky Oil	$232	509,183	$63.8
Penn West	$134.9	445,950	$55.9
Top ten		**8,244,715**	**$1,033.7**

Notes:
1. Company third quarter reports, 2000.
2. BC Ministry of Energy and Mines, December 2000.
3. Estimate by author based on 2000 production, and Gilbert and Associates BC price forecast of $5.55 for 2001, less $2 producer costs and royalties = netback of $3.55 mcf.
4. US Dollars. Exxon-Mobil consolidated 3Q 2000 net earnings; financial results for Mobil Canada not available.
5. 12 month earnings, Anderson Exploration 4 Quarter and fiscal year earnings to Sept. 30, 2000.
6. US Dollars. Burlington Resources consolidated 3 Quarter net earnings; financial results for Burlington Resources Canada not available.

costs. It also does not reflect exploration costs.) As the table above shows, natural gas profits from BC operations are contributing significantly to huge profit gains by the oil and gas giants at the corporate level.

The current prices mean huge profits for natural gas producers. According to a BC government study in 1999, the cost of exploring for gas, drilling a well, producing gas, gathering raw gas in local pipelines, processing it so that it can be moved through a pipeline and sending it down a pipeline was $1.30 per thousand cubic feet (mcf). In addition to these costs there are taxes and royalties which were $0.40.[2] These costs are now somewhat outdated. Producer costs have increased and royalties have increased. But with current spot market (short-term) gas sales of $7—$8, producers are still netting $5 or better on spot markets, and $3—$4 on average prices for every thousand cubic feet of gas sold.

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Current price estimates range from a high of $7.50 at the BC wellhead for 2001, according to oil and gas consultants Sproule Associates,[3] to a lower $5.55 at the BC plant gate, according to Gilbert Laustsen Jung Associates.[4] Both analysts agree that prices are not expected to return to last year's levels until 2003.

After fifteen years of deregulation, what can be done now to soften the blow of price increases for natural gas? After all, we live in a cold climate and heating our homes is hardly a luxury.

In truth, governments have several policy alternatives left to them, even though they have already deregulated on a continental basis, and creating a new regulatory framework that would make sense would be a complicated matter indeed.

Over the longer term, the federal government is likely the government best situated to take effective action on the

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gas market. For example, the federal government has the ability to put a lid on any new pipeline capacity to the United States, thereby creating a more favorable supply and demand market for Canadian consumers. All new capacity makes Canadian prices more dependent on American market prices.

Ultimately, if Canada wants to return to a regulated, stable domestic price, the terms of NAFTA must be reconsidered.

In the shorter term, the federal government should also impose an excess profits tax on oil and gas companies that are realizing windfall profits because of market conditions in the United States. A federal tax, applied across Canada, would address the problem of inter-provincial competitiveness. These funds could be redirected to a consumer relief program in conjunction with the provinces.

At the provincial level, hard decisions have to be made about how much of the royalties should be used to offset consumer prices. In the BC case, if $200 million was allocated for consumer relief, and applied equally to the province's 845,000 regulated gas consumers, it would offer only about $236 per household – or a little less than half of the average annual increase resulting from the latest 27% increase. The rebate would be larger, of course, if targeted to low income households.

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Many, no doubt, would be pleased to hear some positive news before winter ends.

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Fred Wilson is a National Representative with the Communications, Energy and Paperworkers Union of Canada, and a Research Associate with the Canadian Centre for Policy Alternatives.

A longer policy brief of this Behind the Numbers is also available.
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Notes:

1. In 2001, the new regulated consumer price for natural gas (BC Gas) is over $13.00 per thousand cubic feet (mcf). The rate per thousand cubic feet (mcf) can also be described in Gigajoules (GJ) or millions of BTU (MMBTU) at $12.42. Natural gas units are also expressed in thousand cubic metres (M^3), which is approximately 35 times larger than per unit of mcf. Unless otherwise specified, all units expressed in this paper are in thousand cubic feet (mcf).

2. BC Ministry of Mines, Energy and Resources, Natural Gas Industry Competitiveness Study, September 1999. This study is based on average costs in the Ft. St. John region and may differ in other regions of northeast BC. In addition, data is based partly on information dating to 1995. A revised cost estimate will be completed in 2001, but Ministry officials indicate that some costs such as drilling may have increased as much as 25% in the past year as a result of competition for rigs.

3. Sproule Associates Limited, Natural Gas Price Forecasts – Various Shippers as of Jan. 1, 2001.

4. Crowfoot, Carol, Senior Energy Economist, Product Price and Market Forecasts for the Canadian Oil and Gas Industry, Gilbert Laustsen Jung Associates Ltd., Quarterly Update, January 1, 2001.

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