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*** BY EMAIL ONLY TO ROYALTYREVIEW@GOV.BC.CA ***

To Whom it May Concern:

Re: Oil and Gas Royalty Review

Thank you for the opportunity to comment on the review of BC's Oil and Gas royalty system. While we are deeply concerned with the relationship between the oil and gas industry, environmental protection and BC's climate action, we have struggled with what to say in the context of this review because of the narrow scope of the review and the supporting documents.

BC's Roadmap to 2030 promises that this review will:

Integrat[e] emissions goals into the oil and gas royalty system ... The review will examine ways to adjust the royalty system to help meet provincial emission reduction targets.

However, the Review, as framed, fails to deliver on this promise. The Review documents characterise the royalty system as focused on economic return while consistently ignoring the economic costs associated with environmental and climate concerns. As a result, the Review pre-supposes the continued or increasing production of oil and gas, focusing largely on maximizing economic return to the province based on that assumption, with environmental and climate objectives achieved primarily through other mechanisms (which, conveniently, are not under review at this time).

In our view, ensuring the maximization of revenue from the oil and gas industry to the Province ignore the costs that we have collectively experienced over the past several months – heat waves, wildfires, floods and landslides – as well as similar impacts experienced around the world, as a direct result of the use of these products. These costs are going to get worse and must be addressed in the Review if it is to have any credibility.

What costs are appropriate to include in the royalty review?

According to the paper prepared by Nancy Olewiler and Jennifer Winter, a royalty system:

... is a mechanism for sharing between the government and lease-holder the **net returns** arising from natural resource extraction. The structure of royalty rates is intended to maximize the **net returns** to the province whilst not unduly affecting the competitiveness of the industry. ... [Emphasis added]

Its purpose is focused on sharing the “economic value created by developing those resources.” As the paper notes, “[m]easuring economic value is challenging. It requires answers to such questions as: what price to use, which costs to deduct, and how both are measured.”

The economic costs associated with climate change are increasingly recognized, not just in theory but also in this year’s floods, landslides, wildfires and heat dome. Any calculation of the economic value created by the development of oil and gas that fails to recognize those costs to the public would maintain an economic externality, and consequently encouraging the production of oil and gas that is actually uneconomical from a societal point of view.

However, none of the Review documents acknowledge that environmental or climate harm has economic value. While Olewiler/Winter acknowledge that higher royalty levels will decrease GHG emissions (and lower ones raise them), they nonetheless fail to discuss the economic value associated with lowering emissions, instead writing:

[C]hoice of royalty rate and any royalty credits is, and should be, a decision about appropriate share of value. There are other, more appropriate policy mechanisms to address emissions directly rather than through the royalty system.

The fact that the diminishment in value associated with increased emissions is not discussed in the paper entirely calls into question this conclusion. Furthermore, this statement is simply made, without discussion of the pros or cons of a regulatory vs. royalty based approach to addressing production.

Incorporating externalities into royalties

While the setting of royalties has ostensibly been focused on profit-sharing, it is inaccurate to say that this is the sole focus of royalty systems. Governments have often used royalty systems to encourage and discourage certain behaviours or to promote certain types of economic growth over time. As Hein and Cecot point out in their 2017 paper on mining royalties:

While royalties typically have a revenue or profit-sharing component, a common thread in our research that may be especially relevant to federal and state governments is that royalties have historically been used as policy levers to help set national, state, or private priorities for land, resources, or property use. For example, [governments have] set royalties at specific rates to encourage resource production, encourage westward expansion, and deter socially undesirable behavior. Accordingly, this article concludes that it would be reasonable for ... governments to adjust mineral royalty rates to account for negative externalities that are not otherwise addressed by regulation, or to otherwise promote public welfare.¹

There are very good reasons to address the economic impacts of burning oil and gas through the royalty system. Unlike some externalities, which are not the inevitable result of extraction but rather of the design of

¹ Hein, Jayni and Cecot, Caroline, Mineral Royalties: Historical Uses and Justifications (February 16, 2017). Duke Environmental Law & Policy Forum, Vol. 28, No. 1, 2017, Available at SSRN: <https://ssrn.com/abstract=2918357> or <http://dx.doi.org/10.2139/ssrn.2918357>.

the extractive method, CO₂ emissions, and the resulting harm, are the inevitable result of the end use of the vast majority of oil and gas extracted; combustion is the purpose for which it is being extracted.

While BC's carbon price does capture some of the economic value associated with the burning of fossil fuels in the province, the majority of oil and gas extracted in BC is intended for export and the combustion occurs in other jurisdictions, meaning that those costs cannot be captured or prevented through regulation in BC, except through royalties or other point-of-extraction regulation.

The extraction of oil and gas imposes direct costs on communities in BC and around the world. If these are not captured through royalties, then the government of BC is putting taxpayers on the hook for these costs. In addition, in relation to Indigenous Peoples, the United Nations Declaration on the Rights of Indigenous Peoples (incorporated into BC law in the UNDRIP Act) expressly requires the government to put in place avenues of redress and compensation for actions that will negatively impact their territories and rights.²

Quantifying economic costs associated with oil and gas production

While it is difficult to come up with a definitive number that quantifies the economic costs resulting from oil and gas production, there are a number of surrogates that could be used.

First, the current carbon tax price (rising to \$170/tonne in 2030) could be applied to the emissions associated with the produced oil and gas. This may require adjustment in the small number of instances where the oil and gas is used in BC, as the price will also be collected at that time.

Second, the Canadian government has recently indicated its intention to update its estimate of the social cost of carbon in light of recent research indicating that each tonne of CO₂ costs society between \$135-\$440 per tonne of CO₂ emitted.³ Social Cost of Carbon attempts to quantify the harm associated with each tonne of carbon dioxide entering the global atmosphere.

It is our recommendation that BC set royalties at levels that reflect the provincial carbon price as a reflection of the climate harm caused when the oil and gas are burnt. As the carbon price increases, and existing royalty credits are exhausted, this predictable increase in royalties will incent the industry to wind down, consistent with what is required to address climate change.

Sharing of Royalties

Recognizing that oil and gas production creates economic costs for society through climate impacts, and reflecting those costs in the royalty structure, means that the question must be raised of how to get those royalties to those who are incurring those costs.

² UNDRIP, Article 28.

³ <https://gazette.gc.ca/rp-pr/p1/2020/2020-12-19/html/reg2-eng.html>.

The BC government does incur climate costs, in terms of damage to its own infrastructure and the costs of emergency response, and some of the funds raised should be dedicated to emergency response in the province and the costs of climate adaptation.

Local governments and First Nations governments also directly incur climate-related costs and have few options to raise funds to address them. The royalty system must provide for the sharing of resources with these other levels of government, reflecting the climate harm associated with oil and gas.

Similarly, Canada has nationally committed to pay funds towards the costs of developing countries to adapt to climate change, and other governments, including sub-national governments such as Scotland, have committed to funding losses associated with climate change. British Columbia should consider making a portion of royalties available through international climate funding initiatives.

Any remaining funds could be put towards the CleanBC Industry Fund with a special emphasis on assisting the oil and gas industry in transitioning away from producing oil and gas for combustion.

Other specific measures

While we fundamentally disagree with the narrow view of royalties taken in the Review, we do want to indicate our support for:

- Ensuring that any royalty system is based on a flat rate and does not allow for cost recovery, thereby ensuring that less economic wells will not be developed;
- removing incentives within the system that subsidize the development of inefficient wells; and
- ensuring that the full cost of methane emissions escaping from wells is included in the royalties, ensuring that there is an incentive to reduce such leakage.

These fixes are easy and must be implemented.

Conclusion

The documents developed to inform the Royalty Review are flawed in that they ignore the reality that the production of oil and gas brings with it an economic cost. A failure to address that reality, and to ensure that those costs are captured and shared with those who are incurring those costs, represents a subsidy to the oil and gas industry. That is inconsistent with meeting BC's climate goals, and inconsistent with the changes in the industry that are required to move to a net-zero carbon future.

Sincerely,



Andrew Gage,
Staff Lawyer