The Oil Drum: Canada
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

The Round-Up: June 15th 2007

Posted by Stoneleigh on June 15, 2007 - 8:58am in The Oil Drum: Canada
Topic: Miscellaneous
Tags: atlantic accord, credit bubble, emissions, equalization, foreclosure, income trusts, kyoto, leveraged buyout, mackenzie valley pipeline, nuclear waste, oil sands, private equity, recession, taxation [list all tags]

Trust tax linked to private equity buyouts

> The income trust structure was a major impediment to private equity firms buying up pieces of Corporate Canada, the Finance Department was told one day before Ottawa slapped a crippling tax on the sector.
>
> "Private equity firms generally find it difficult to compete against the income trust alternative, said an Oct. 30, 2006, memo sent to Bob Hamilton, senior assistant deputy minister of tax policy at the Finance Department.
>
> The memo was obtained by The Globe and Mail under access to information law.
>
> For anyone at Finance who knew the trust tax was imminent, one conclusion that's easily drawn from the memo is that taxing trusts out of existence would likely usher in even more private equity buyouts by Canadian and foreign investors, which is what happened.

What Price Victory? (scroll down)

> It’s reasonable to assume that, as professionals operating within a government department nominally charged with understanding affairs of finance, the folks working for Flaherty would have some rudimentary understanding of the way key players in the private space—private equity, for example—operate.
>
> That is private-equity firms find undervalued, cash-generating businesses, strip them down and load them up with debt. Interest expenses basically wipe out taxes owed. That’s the nutshell.
>
> What was that about “tax leakage”?
>
> Either the professionals have no clue about their business, or they engineered the destruction of the trust sector. Secretive, incompetent and stupid is no way to run a government.

Saskatchewan will sue over equalization: Calvert

Calvert said a lawsuit isn't his preferred way to deal with the dispute over the federal program, but he tried negotiations and calling on Saskatchewan MPs to vote against the budget and nothing worked.

"This is a very poor way to run a country," Calvert said.

Equalization is the $12 billion program under which Ottawa makes payments to poorer provinces so they can afford the same services and tax rates as richer provinces.

Thanks to surging oil and gas revenues, Saskatchewan has received virtually no equalization money in the past few years.

During the election campaign, the Conservatives promised to take non-renewable resources like oil and gas out of the equalization formula - a change Calvert said would mean an extra $800 million a year for provincial coffers.

The March 19 budget did remove oil and gas from the formula, but added a cap on equalization payments. As a result, Saskatchewan is getting $226 million this year and nothing next year.

Williams won't rule out joining Saskatchewan legal action

"If there's a point where Premier Calvert wanted us to tag along or add on to give strength to his application that's something we'd seriously consider," Williams said.

"I'll just have to wait and see what the gist of the argument is. It may be a Saskatchewan-unique argument that he presents, but if it's not, if it's a general argument, it may not be too late for us to participate if that makes sense."

Though Harper earlier this week dared the provinces to pursue legal action if they were unhappy with the deal, Williams said he has not seriously considered the option until now.

Jim Flaherty: myth monger

Flaherty writes in the Chronicle Herald:

Let me be clear, Canada’s New Government is honouring the Atlantic accords fully in its budget.If this were true, Flaherty would not need to amend the 1985 Accord, in his budget bill, thereby violating section 60 of the 1985 agreement.

Since he is applying a cap to the 1985 and 2005 agreements, he is also not honouring either the letter or spirit of either agreement.

Atlantic provinces to lose billions in new formula: study

Nova Scotia and Newfoundland and Labrador have been critical of Prime Minister Stephen Harper for turning his back on a 2006 campaign promise to exclude non-renewable resources - particularly offshore oil and gas - from any new formula.

But the APEC study finds that the new formula will also mean less money for New Brunswick and Prince Edward Island.

Memorial University economics professor Wade Locke, a co-author of the report, said Nova Scotia and Newfoundland and Labrador are already aware they will each lose about $1.4 billion by 2020.

Locke predicts that New Brunswick will lose about $1 billion over the same period, while P.E.I. would receive almost $200 million less.

Locke is careful to not pass any judgment on his findings, although he dismisses the federal government's suggestion that Nova Scotia and Newfoundland and Labrador could stick with the outgoing equalization formula for a period of time.

"Since other provinces are not offered this choice, this would result in an unprecedented situation in which there are two distinct equalization programs operating simultaneously," said Locke.

[McGuinty warns against new deal]

Premier Dalton McGuinty waded yesterday into the fracas over the federal budget, warning that Ontario won't tolerate any further steps to shield resource-rich provinces from equalization clawbacks.

McGuinty warned Stephen Harper against making any further concessions to Newfoundland and Labrador, Nova Scotia and Saskatchewan.

The three provinces have accused the prime minister of reneging on a promise to allow them to reap the full benefit of their oil and gas revenues without any reduction in equalization payments.

[World oil supplies are set to run out faster than expected, warn scientists]

Scientists have criticised a major review of the world's remaining oil reserves, warning that the end of oil is coming sooner than governments and oil companies are prepared to admit.

BP's Statistical Review of World Energy, published yesterday, appears to show that the world still has enough "proven" reserves to provide 40 years of consumption at current rates. The assessment, based on officially reported figures, has once again pushed back the estimate of when the world will run dry.

However, scientists led by the London-based Oil Depletion Analysis Centre, say that global production of oil is set to peak in the next four years before entering a steepening decline which will have massive consequences for the world economy and the way that we live our lives.

According to "peak oil" theory our consumption of oil will catch, then outstrip our discovery of new reserves and we will begin to deplete known reserves.

> Colin Campbell, the head of the depletion centre, said: "It's quite a simple theory and one that any beer drinker understands. The glass starts full and ends empty and the faster you drink it the quicker it's gone."

June 14, 2007: The Day "Peak Oil" Became a Household Word

> The FT story also had the obligatory dismissal of Peak Oil from BP's chief economist Peter Davies: "We don't believe there is an absolute resource constraint. When peak oil comes, it is just as likely to come from consumption peaking, perhaps because of climate change policies or for some other reason, as from production peaking."
>
> I read the story yesterday, made the mental note to myself "nothing new," and moved on to other affairs.
>
> But today, Britain's Independent newspaper did a follow-up story that led thus:
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> "Scientists have criticized a major review of the world's remaining oil reserves, warning that the end of oil is coming sooner than governments and oil companies are prepared to admit."
>
> The article's publication was not a particularly big deal by itself. But then Matt Drudge linked to it. Fairly high up on his home page, too -- "PAPER: A WORLD WITHOUT OIL COMING SOONER THAN PREDICTED."
>
> In the space of just a few hours, millions of Internet users have become familiar with Peak Oil through the Independent article.

A Crude Awakening - The Oil Crash

> Our film "A Crude Awakening - The Oil Crash" is now available as a DVD for Canadian residents. Part of the proceeds went towards setting up ASPO Switzerland

Radioactive tritium in Great Lakes puts kids at risk: study

> But the latest concerns about tritium aren't enough to change the province's course when it comes to bringing more nuclear reactors online, he said. "We will continue to move forward with refurbishment of nuclear generation and to construct new generation where required," McGuinty said. "Over time there will be a reduced percentage of our electricity that's coming from nuclear generation."
>
> A study (pdf warning) commissioned by Greenpeace, released yesterday, found Canada's standards for tritium exposure are "lax" compared to the rest of the world, especially in light of new evidence suggesting the material is more dangerous than thought.

Tritium levels dangerously high at Pembroke factory: report

> Mr. Fairlie said he was astonished at the tritium emissions levels at the Pembroke plant in 1997, 1998 and 2000 -- which approach "the level of a big nuclear power station."
>
> Those levels remained extremely high until 2002 and have decreased steadily since then. Mr. Fairlie nevertheless says the risk of contamination, especially for workers and their families, remains real.
>
> "In practical terms, these are humongous amounts of tritium," Mr. Fairlie said in a telephone interview. "I would say that people living within a couple kilometres of the plant should be measured for certain levels of tritium."

Ottawa backs nuclear industry on waste

> Gord Edwards, director of the Canadian Coalition for Nuclear Responsibility, said Mr. Lunn's endorsement of underground waste storage represents a public relations coup for the nuclear industry.
>
> Despite the long-term plan, the risk of a catastrophic event will grow if the industry expands, he said. That's because it takes at least 30 years before the fuel can be moved underground and so the amount of radioactive waste kept on the surface will rise.
>
> "In the face of a growing nuclear industry or even a static nuclear industry, this is not really a solution to the catastrophe problem at the surface," Mr. Edwards said. He said any kind of major explosion - such as a terrorist attack - at a surface storage site would release radioactive clouds as deadly as those at the Chernobyl reactor that melted down in the former Soviet Union in 1986.
>
> Ottawa and the nuclear industry - led by Atomic Energy of Canada Ltd. - have been working for decades on a long-term storage solution. In 1998, a federal report concluded that underground storage of nuclear waste was technically feasible but could not be sold politically because of the high level of opposition from Canadians.

Oilpatch stands by tech fund

> Canadian oil and gas companies are asking the federal government to encourage technology development, rather than emissions trading, in the fight against climate change.
>
> In a letter this week to Jim Prentice, the Indian Affairs Minister, who led the greenhouse-gas debate for the federal government with the booming sector, the Canadian Association of Petroleum Producers says it supports the new Conservative environmental plan.
>
> But it also says it is concerned it restricts and then phases out contributions to a technology fund, forcing large emitters to buy offsets in an uncertain market rather than fix its greenhouse-gas emissions problem.
>
> The plan sets targets that are higher than those imposed in other countries and that the oil-and-gas industry will not be able to meet in the near term at an acceptable cost, which means it will have to look at other ways to comply, Kathy Sendall, former CAPP

chairwoman and senior vice-president at Petro-Canada, says in the letter.

By phasing out the technology fund, the rules eliminate the intended contribution of technology and divert resources to pay for other sectors' and other countries' reductions, Ms. Sendall said.

TD calls in big guns to grease oilpatch wheels

In an acknowledgement that oil and politics are mixing a lot more, TD Securities Inc. is taking the inside track to expanding its Canadian energy business and recruiting three of Alberta's most senior former politicians to open oilpatch doors and provide feedback on policy issues.

Jim Dinning, the former Alberta treasurer who last year lost the race to replace Ralph Klein as Alberta premier; Murray Smith, the former Alberta energy minister and, until next month, the province's representative in Washington; and Anne McLellan, Canada's former deputy prime minister and federal natural resources minister, have joined the newly struck TD Securities energy advisory board, the bank said yesterday.

The board is chaired by another former politician -- Frank McKenna, a former Canadian ambassador in Washington and a former premier of New Brunswick, who is also the deputy chair of TD Bank Financial Group.

The move comes as risk to Canadian oil and gas projects is increasingly, stemming from decisions made in Edmonton and Ottawa about such areas as climate change, royalties and taxation, rather than from commodity prices or availability of capital.

Albertas oil sands threaten water supplies

Current provincial regulations dont protect the Athabasca River system, the industrys source of water in and around Fort McMurray, Alberta. As a result, oil production in the area has spiraled without meaningful environmental safeguards. The controversy about the state of the Athabasca prompted scientists at the University of Toronto and the University of Alberta to assess the impact of oil production on the provinces water resources. In a report (PDF size: 2.1 MB) issued on May 10, the scientists conclude that the explosive demand for water has put the oil industry on a collision course with the river, which is rapidly drying up because of warming temperatures.

Mackenzie pipeline panel faces further delays

The joint review panel, which is looking at the environmental and social impacts of the $16.2-billion project, has been criticized for taking much longer to do its job than originally anticipated.

Now the panel says it wants to hear what the project's interveners have to say about a motion filed last week by the Sierra Club and the World Wildlife Fund before finalizing its schedule.

The two environmental groups want the panel to look beyond the pipeline project and study the cumulative effects of gas development in the Mackenzie Valley.

[There's Money to Be Made in Alaska's Resources]

When I arrived here in Anchorage, the lead business story in the Anchorage Daily News concerned the proposed "Arctic Gas Line" that people have desired for decades to build from the North Slope, down through Canada's Mackenzie Valley and into the U.S. The headline in the newspaper states, "Exxon Frets Over Arctic Gas Line Cost."

You have surely heard of the vast oil resources of the North Slope. To date, more than 13 billion barrels of oil have been pumped from beneath the frozen tundra of Prudhoe Bay and environs, with more to come.

But there is also an immense resource of natural gas in the rocks below. In fact, moving west from Prudhoe Bay, the reservoir rocks dip downward and are buried deeper and deeper. Many exploration geologists believe that any hydrocarbons that will be found are probably in the form of natural gas, not oil. So the next big play in the northern Alaska region will likely be natural gas drilling. But as with much else that occurs in Alaska, progress is measured in glacial increments.

[This Time Its Value Traps]

Most financial bubbles are pretty easy to spot: An asset class climbs way beyond what old-fashioned valuation measures used to define as reasonable, market participants start acting like idiots, and pundits rationalize the madness with learned new era theories. Think late-90s tech stocks or California houses in 2005 or today's Shanghai stock market. This kind of bubble announces itself loudly, making it easy to ridicule and/or bet against.

But todays U.S. stock market is a different, trickier, far more dangerous kind of bubble, because the stocks that are wildly overvalued actually look pretty cheap by traditional measures: Banks and brokerage houses at 12 times earnings, homebuilders at 1.5 times book, retailers at 1 times sales. In terms of historical trading ranges, there seems to be nothing here to get excited about.

But look a little closer and you see that these are classic value traps, stocks that seem cheap but are actually wildly overvalued because their underlying earnings, book value, dividend yield or whatever are artificially inflated. Value traps are common at the end of long expansions, when corporate earnings have spiked because of supply constraints, but stocks haven't, as investors begin to suspect rightly that demand is about to slow, thus compressing profit margins and sending earnings off a cliff. Hence the juicy-looking valuations.

[On a Clear Day, Wall Street Faces a Hurricane of Paper]

"Hedge-fund managers, buyout barons, investment bankers and oligarchs are infected more by greed than by fear largely because they often have safety nets. Managers of hedge funds and private-equity firms -- the two dominant species in the modern financial jungle -- typically collect 20% of the profits when things go well. But they don't share in the losses when things go badly. This one-way bet accentuates greed and blunts fear." As EWFF has also noted, bankers are similarly inclined because they "don't make loans the way they did in the past, keeping the risk of default in-house. Instead, they mainly originate loans, collecting fees. As long as bankers can play this game of pass the parcel, they don't face much risk."

The loans are then doled out to syndicates which are taking increasingly exotic forms. "In many cases, the suppliers of debt (particularly for leveraged buyouts) are collateralized loan obligations (CLOs) and hedge funds that specialize in credit. These, too, earn fees by cranking out deals. Since they aren't principally playing with their own capital, their risk appetites also are skewed. This cat's cradle of one-way bets doesn't just anesthetize fear. It encourages a breathless accumulation of assets. If the public is willing to let you play 'heads I win, tails you lose' with $1 billion, that's pretty nice -- but how much better to play with $20 billion." As the May issue of EWFF noted, however, there is an important catch that is starting to turn up in the subprime mortgage area where the decline is already well established. When the trend reverses, these well-dispersed risks become a huge burden because they make establishing and complying with workouts and bankruptcy terms hopelessly complicated. As EWFF noted in May, scattered syndicates mean "more parties must comply with the terms of each default," which slows "down decision making enough to turn even a mild recession into 'systemic disaster.' In this way, the financial engineering that pushed debt levels, valuations and investor optimism through the roof on the way up reverses and will foster an atmosphere of rising caution, falling prices and ill will."

[Unprepared for the Rainiest of Days]

The only way we can square it up with our creditors is to sell them chunks of our country. We are like a rich drug addict who sells off the family heirlooms to finance his habit. Our habits are oil and Japanese and German cars and French wine and Bolivian tin and Chilean copper, and, little by little, we are transferring ownership of our nations wealth to pay for it.

Some sour day, the world will look at our deficits and at our dollar and say it doesnt want to hold our greenbacks as reserve currency any more. It will say, I will take the euro instead, or a basket of currencies which is already happening. Then the dollar will fall, maybe drastically, and the trade deficit will soar. After all, were addicts who cant stop buying foreign resources and products. When that happens if it does the inflation will be staggering.

And then, of course, we end up as the worlds leading industrial basket case, a ward of China in matters economic, our freedom of maneuver hemmed in drastically because foreigners own so much of us and of our labor to service the debts.

Then there is Medicare, which has an unpaid liability of about $34.2 trillion over the next 75 years, and more like $75 trillion over a longer period. This is perilously close to the value of all of the physical assets of the United States. That has certain implications for whether we can really count on Medicare as we age.

[Rules 'hiding' trillions in debt]

> The federal government recorded a $1.3 trillion loss last year — far more than the official $248 billion deficit — when corporate-style accounting standards are used, a USA TODAY analysis shows.
>
> The loss reflects a continued deterioration in the finances of Social Security and government retirement programs for civil servants and military personnel. The loss — equal to $11,434 per household — is more than Americans paid in income taxes in 2006.
>
> "We're on an unsustainable path and doing a great disservice to future generations," says Chris Chocola, a former Republican member of Congress from Indiana and corporate chief executive who is pushing for more accurate federal accounting.
>
> Modern accounting requires that corporations, state governments and local governments count expenses immediately when a transaction occurs, even if the payment will be made later.
>
> The federal government does not follow the rule, so promises for Social Security and Medicare don't show up when the government reports its financial condition.
>
> Bottom line: Taxpayers are now on the hook for a record $59.1 trillion in liabilities, a 2.3% increase from 2006. That amount is equal to $516,348 for every U.S. household. By comparison, U.S. households owe an average of $112,043 for mortgages, car loans, credit cards and all other debt combined.

Former Fed official: One of four U.S. jobs headed overseas

> Alan Blinder, former vice chairman of the Federal Reserve, told Congress Tuesday (June 12) that one out of four U.S. jobs are vulnerable to offshoring. Blinder, now an economics professor at Princeton University, told the House Science and Technology Committee that American jobs in science, technology and engineering are most vulnerable to offshoring.

U.S. Mortgages Enter Foreclosure at Record Pace

> The number of Americans who may lose their homes because of late mortgage payments rose to a record in the first quarter, led by subprime borrowers pinched by an economy that grew at the slowest pace in four years.

U.S. Home Foreclosure Report: May 2007

> The Center for Responsible Lending is estimating that on average 16 to 20 percent of subprime mortgage borrowers across the U.S. will eventually lose their homes to foreclosure. Projections from the Center are even higher for states like Arizona, California, Hawaii, Nevada, New York, and states in the Midwest.
>
> 'Some neighborhoods are expected to lose 70 percent of their housing stock,' said John Taylor, president of the National Community Reinvestment Coalition (NCRC). 'These

> are mortgage sinkholes. The predatory lending issue may be the thing that pushes us to a recession.'

An Enormous Rout in Treasuries (The Survival Report - Agora Financial subscription service)

> In the past few weeks, there has been an enormous rout in Treasuries. Yields on the 10-year note have risen from 4.50% early in the year to the current 5.21%. When the 10-year Treasury yield rises, mortgage rates jump right along with it.
>
> The current rise in yields was the " biggest weekly jump in three years ":
>
> " 'Mortgage rates moved sharply upward this week, with rates on 30-year fixed-rate mortgages jumping more than 20 basis points, the largest upward movement in over three years,' said Frank Nothaft, Freddie Mac."
>
> This spike in rates is not going to do housing any good at all. There was a record number of foreclosures in the first quarter, and RealtyTrac is reporting, "More Than 176,000 Americans Entered Foreclosure in May ":
>
> > "Irvine, Calif.-based RealtyTrac says more than 176,000 people got foreclosure notices last month. That is the highest figure they have ever recorded in their monthly report and is 90% higher than the numbers from a year ago.
> >
> > "'Such strong activity in the midst of the typical spring buying season could foreshadow even higher foreclosure levels later in the year,' said James Saccacio, CEO of RealtyTrac, in a release accompanying the data."

Canada: Another round of mortgage rate hikes

> The posted five-year mortgage rate will have gone from as low as 6.59 per cent to 7.44 per cent since May 17 - a jump of 0.85 percentage points.
>
> Last month, the Bank of Canada sent unmistakable signals that borrowed money was about to get more expensive.
>
> Yields in the bond market, where mortgage financing is determined, have been rising since the central bank delivered a strong hint that it would hike interest rates - and perhaps more than once this year - to fight inflation.
>
> In a speech Wednesday, Bank of Canada governor David Dodge repeated the language he used back in May to warn of future rate hikes. "Some increase in the target for the overnight rate may be required in the near term to bring inflation back to the target," he told an audience in St. John's.

Canada: Housing boom roars on - longer mortgages and new products aid buying spree

> Canada's scorching housing market shattered a string of records in May amid signs Canadians are flocking to 30-and 40-year mortgages to get a foot on an increasingly pricey property ladder.

Longer amortization periods against a backdrop of higher interest rates, tightening credit standards and carnage in the US housing market is very bad news for Canadian real estate. The view from the peak may be good, but there's nowhere to go but down.

Schwarzenegger threatens lawsuit to allow California's emissions standards

> Gov. Arnold Schwarzenegger said Wednesday that a lawsuit to force the federal government to permit California to move forward with its tough vehicle emissions is now "inevitable."
>
> Earlier, California Attorney General Jerry Brown, a Democrat, pledged that a lawsuit would be filed in October against the Environmental Protection Agency unless it issued a Clean Air Act waiver allowing California to force new cars and light trucks to meet stricter emissions standards than federal law requires.
>
> The Republican governor told EPA Administrator Stephen Johnson in a letter Wednesday that a lawsuit is now a virtual certainty. It followed Johnson's testimony before an ad hoc House of Representatives global warming panel on Friday in which he said he wouldn't decide on the state's application until the fall of 2008.
>
> California is the only state that's permitted to have tougher laws than the federal government to control air pollution under the Clean Air Act, but to do so it must have a waiver. Once issued, other states are free to adopt the California standard. So far, at least 13 other states have enacted, or soon will enact, laws following California's lead on greenhouse gas emissions.
>
> The state's waiver application has been pending since 2005. The state gave notice in April that it would file a lawsuit in October unless the agency made a determination on the waiver by then.

Russia eyes 700-million-euro Kyoto windfall

> Russia’s electricity monopoly United Energy Systems hopes to attract investment worth 700 million euros under the Kyoto Protocol to combat global warming, CEO Anatoly Chubais said on Thursday.
>
> But he also issued a warning to consumers that they would have to foot the bill for technology needed to limit emissions within Russia, where electricity production has been booming.
>
> ‘Our aim is to attract no less than 700 million euros (934 million dollars) on account of the Kyoto protocol,’ Chubais told a conference on Friday on his company’s environmental policy.
>
> But the company, whose subsidiaries account for 25 percent of Russia’s carbon dioxide

> output, will need far more financing to keep its emissions from growing, he warned.

[Growing corn for green fuel could ignite Gulf of Mexico dead zone]

> Growing corn in the Midwest for green fuel could increase pollution downriver and contribute to a "dead zone" that forms each summer in the Gulf of Mexico, a national agriculture expert said Tuesday.
>
> "We're in a dilemma in this country," Gary Mast, of the U.S. Department of Agriculture said Tuesday. "We want food. We want fuel. We want it to be produced environmentally soundly."
>
> The problem is that corn needs more nitrogen fertilizer than other crops. More corn means more nitrogen fertilizer. Runoff carrying the fertilizer fuels the growth of microscopic organisms that then die, fall to the bottom and decompose, using up the oxygen there.