Standing Committee on Finance (FINA)

Pre-budget consultations 2012

Encana Corporation

Responses

1. Economic Recovery and Growth

Given the current climate of federal and global fiscal restraint, what specific federal measures do you feel are needed for a sustained economic recovery and enhanced economic growth in Canada?

Canada could be at the forefront of the liquid natural gas (LNG) industry to grow and diversify export markets for Canadian natural gas. There is a window of opportunity now for government to ensure Canada is competitive to positively influence final investment decisions for the numerous LNG export facilities that have been proposed in Canada. As an investor in one of the potential LNG export facilities in Canada, Encana strongly believes that government should change the tax treatment of LNG export facilities (currently Class 47, with an 8% declining balance) to the same as that afforded to like facilities such as straddle plants (Class 43, with a 30% declining balance). The timing of this change is important as it will influence the final investment decisions that are currently under consideration. The current tax classification for LNG export facilities in Canada is not equitable with like facilities across the country. Similar to a straddle plant, LNG export facilities utilize many of the same processes to treat natural gas. Considering the comparable nature of the processing being done in these facilities, a reclassification for LNG export facilities to Class 43 is justified. The proposed change will significantly help the economic viability of these multi-billion dollar investments. It is critical that this reclassification occur now, as numerous operators are in the process of making their final investment decisions, which will impact the success of Canada's LNG export industry. Market diversification in the form of LNG exports to Asia is a key factor for the continued prosperity of Canadian natural gas. Asian demand for natural gas continues to rise. By 2020, it is expected to more than double, growing to approximately 65 bcf/day. Fierce global competition exists to supply the rapidly growing demand for natural gas in Asia from countries such as U.S., Russia, Qatar, Iran and Australia. The Canadian industry needs an investment environment on par with contending jurisdictions like the United States. The proposed reclassification has the potential to solidify final investment decisions and allow Canada to capture a share of the global market.

2. Job Creation

As Canadian companies face pressures resulting from such factors as uncertainty about the U.S. economic recovery, a sovereign debt crisis in Europe, and competition from a number of developed and developing countries, what specific federal actions do you believe should be taken to promote job creation in Canada, including that which occurs as a result of enhanced internal and international trade?

Encana recommends that government change the tax treatment of LNG export facilities to Class 43, with a 30% declining balance claim rate. This will increase the likelihood of positive final investment decisions which would result in well paying, high quality jobs for Canadians both in the upstream sector and the LNG export industry. Numerous LNG plants are in the planning stages, however no final investment decisions on these proposed facilities have been made to date. Positive investment decisions would create many highly skilled jobs across the country. As importantly, it will ensure that jobs are not lost due to further declines in basin production, which is a serious risk if Canada is not able to diversify and gain a foothold in the international LNG markets. Encana, Apache and EOG, are partners in the Kitimat LNG project, which is expected to be operational in 2017 (pending a positive final investment decision) and is designed to export 1.4 bcf / day. When combined with other proposed LNG export facilities plants, the total export capacity of an estimated 4 bcf/day will exceed BC's current total production. According to BC's LNG strategy, if three of these plants move forward, $20 billion will be invested in new facilities and create up to 9,000 construction jobs and more than 800 direct, long term jobs building and operating the facilities. In addition to creating jobs in the LNG sector, investment in LNG export facilities will drive investment into the upstream sector to meet the new demand. Traditional organic investors as well as Asian firms such as Mitsubishi, Kogas, Petronas, and CNOOC among others have secured long-term supplies of energy by investing in the full value chain, from upstream developments through to the proposed LNG export facilities. Resulting investment in the upstream sector is estimated to be at an 8:1 ratio with investment in LNG export facilities. Accordingly, a $20 billion investment in LNG would result in twenty five years of investment in the upstream sector totaling ~$160 billion and creating ~80,000 jobs per year across Canada, including in the manufacturing sectors in Ontario and Quebec.

3. Demographic Change

What specific federal measures do you think should be implemented to help the country address the consequences of, and challenges associated with, the aging of the Canadian population and of skills shortages?

Canada's aging workforce is a challenge for both government and industry. As the population ages there is upward pressure on the social system and increased fiscal demand on the government. This problem could put downward pressure on industry and economic growth as well as have a negative impact on government revenues. To help address these challenges Encana strongly believes that government should change the tax treatment of LNG export facilities (currently Class 47, with an 8% declining balance) to Class 43, with a 30% declining balance claim rate to help secure positive final investment decisions, which in turn will help to grow the economy. As Minister Oliver recognized in April, 2012 when granting the BC LNG export license, "Canada is well positioned to grow as a global energy superpower. Projects such as this will show the world that we are serious about getting our energy resources to market". Positive final investment decisions regarding proposed LNG export facilities will result in the creation highly skilled jobs in remote northern locations and provide high quality, technical opportunities for First Nations residents, who are largely under-represented in the work force. It will also provide opportunities for First Nation businesses to participate in the development and on-going operation of the facilities. This enhanced economic activity will increase government revenues in order to support Canada's growing aging population. Encana is supportive of the government's efforts to improve First Nations labour outcomes through programs such as the Aboriginal Skills and Employment Training Strategy, the Skills and Partnership Fund as well as the Urban Aboriginal Strategy. Developing highly marketable skills among underutilized First Nations youth will create a new pool of potential employees to replace Canada's aging workforce as people begin to retire.

4. Productivity

With labour market challenges arising in part as a result of the aging of Canada's population and an ongoing focus on the actions needed for competitiveness, what specific federal initiatives are needed in order to increase productivity in Canada?

Canada has a real opportunity to be a strong competitor in the LNG export industry. However, competition in the global market is fierce. As an investor in a potential LNG export facility in Canada, Encana believes that government should change the tax treatment of LNG export facilities (currently Class 47, with an 8% declining balance) to Class 43, with a 30% declining balance, to increase the likelihood of a positive investment decision and enable Canada to capture a greater portion of the global market share, boosting productivity across the industry. The natural gas industry in Canada has a long history of innovation to increase productivity. Developing new shale gas plays using horizontal drilling technology has had a revolutionary impact on the industry, unlocking more than 100 years of supply in Canada alone. This technology also led to new shale gas discoveries in the United States, putting North America in the position of having an over-supply of gas. Increased supply has decreased the United States' demand for Canadian natural gas and led to a 25% drop in our North American market share since 2006. This puts Canada in the unique position of having its only customer become its closest competition, rendering us particularly vulnerable if we are not able to diversify our markets. Given the vast reserves in the United States, Canada's North American market share will continue to decline if new demand sources are not found. Because the natural gas industry operates on economies of scale, productivity will decrease with dwindling market share. Correspondingly, if Canada can capitalize on the potential opportunity provided by LNG exports, not only will we maintain the critical mass needed to sustain a competitive operating environment but we will grow and provide high quality jobs across the country. Securing final investment decisions from potential operators will increase investment and jobs in the upstream and LNG sectors and prevent the potential regionalization of the Canadian natural gas industry.

5. Other Challenges

With some Canadian individuals, businesses and communities facing particular challenges at this time, in your view, who is facing the most challenges, what are the challenges that are being faced and what specific federal actions are needed to address these challenges?

The federal government has committed to opening up new export markets, particularly in Asia. In order to make market diversification a reality, Encana believes that the government should change the tax treatment of LNG export facilities (currently Class 47, with an 8% declining balance) to Class 43, with a 30% declining balance. Canada has a limited window of time to solidify its position on the world stage and the proposed change would be a significant factor in the final investment decisions of key operators of proposed projects. The Canadian natural gas industry has faced considerable challenges in the past number of years. As mentioned, the North American market is over-supplied with natural gas, leading to diminishing Canadian exports and historic low prices as well as corresponding declines in national revenue. The United States has faced the same challenges and now both countries are looking to capitalize on access to new markets and increased market share to grow and supply the world with cleaner sources of fuel into the future. The current Class 47 tax classification puts Canadian LNG export facilities at a significant disadvantage to counterparts in the United States, with 20% less write offs (on a discounted basis) than equivalent US facilities, and a resultant 10% higher after-tax cost for an equivalent facility spend. A reclassification to Class 43 would put Canadian and US LNG export facilities on a competitive level as well as result in an increased internal rate of return, which will positively influence final investment decisions. Canada is competing on a global scale to become a player in this industry. Ernst and Young recently completed a study on challenges facing LNG development in Canada and identified the U.S., Russia, Qatar, Iran and Australia as leaders in the race to export LNG, with new players such as Mozambique also looking to enter the market. Encana believes that the opportunity exists now for government to create a competitive investment climate in Canada that would provide support for the positive final investment decisions that will move these projects forward and open new markets for Canadian natural gas.