Dear Friend of the Pembina Institute,

We now know Albertans do not receive a fair share from energy development in Alberta.

To see the proof, read on in this document.

First, there’s the letter introducing *Our Fair Share: Report of the Alberta Royalty Review Panel*.

— The letter is addressed to Government, but is really speaking to all Albertans. In it, Panel Chair Bill Hunter reminds us that we are the Owners of the province’s energy resources, and that as Owners, we are not receiving our fair share.

Next, there’s a primer on *Our Fair Share*, prepared by the Pembina Institute.

— The primer describes the highlights of the Panel’s report, and show you where you can get more information.

Finally, there’s a letter I wrote to Premier Stelmach, calling on him to implement the full set of recommendations contained in *Our Fair Share*.

I encourage you to do the same with a letter to Premier Stelmach and your MLA. By spreading the word, and letting Alberta’s government know how you feel, you can help to ensure that Albertans get a fair return on their resources.

Siincerely,

Marlo Raynolds
Executive Director
Pembina Institute.
September 18, 2007

Honourable Dr. Lyle Oberg
Minister of Finance
Government of the Province of Alberta
#408 Legislature Building
10800 - 97 Avenue
Edmonton, AB
Canada T5K 2B6

Dear Minister,

The Royalty Review Panel ("Panel") that was created to review whether Albertans are receiving a fair share from energy development through royalties, taxes and fees has completed its work. We retained international-calibre expert advice, reviewed previously done work, reached out to all Alberta stakeholders and citizens, vigorously modelled many scenarios and debated what we learned. Given the time constraints relative to the enormity of our mandate, I am proud to report that we, as a Panel, have come together to recommend a mitigating fiscal program that the government can undertake immediately.

We say "mitigating" because our review revealed that Albertans do not receive their fair share from energy development and they have not, in fact, been receiving their fair share for quite some time. Royalty rates and formulas have not kept pace with changes in the resource base, world energy markets and conditions in other energy-rich jurisdictions. Albertans own the resources. The onus is on government to re-balance the royalty and tax system to ensure a fair share is collected both currently and as circumstances change. This must be done within an equitable, flexible and competent administrative framework that maintains Alberta’s competitive edge for energy investment while
allowing for all the subjective and objective advantages, including political stability, publicly-funded infrastructure, proximity to markets, and the massive size and certainty of our resource, to name a few.

The Panel’s integrated recommendation will achieve the required balance and Alberta’s rightful place in international competitiveness based on current conditions. Albertans must have confidence in those chosen to manage their energy resources for maximum yield across several areas: investments, jobs, taxes, royalties and the value-added sector. To secure this confidence, it is essential to provide an enabling and measurable environment in which to create and assess a fair balance between investment by the private sector—the oft-cited “activity” metric—and revenue generation for the owners, or “What’s in it for us?”

There is an absence of accountability from the government to the owners of the resource. Even with substantial effort, Albertans cannot determine whether their interests are being well served and whether or not the royalty system is performing as intended. By recommending an accountability package in the strongest possible terms, the Panel intends that both government and industry will be forced to gather and produce data so that statistics and actionable information can be reported to the owners. We envision disclosure and analysis that is at least as comprehensive, or better, than would be reported to the owners of any major enterprise handling billions of dollars on behalf of its stakeholders every single quarter, let alone every single year.

Some simple but very basic concepts were helpful to us and will be useful to both government and future reviewers of Alberta’s fiscal regime in the energy sector. For example, when a government designs a tax system, it must justify every dollar or fraction of a dollar it takes away from wage earners and business, because that money belongs to the people who earned it. Alberta’s natural resources belong to Albertans, and this is a different proposition. The design of a royalty and tax system for energy resources therefore must justify every dollar that does not go to the owners. Meanwhile, Alberta must be internationally competitive and developers must be rewarded for their risks and investments. Nonetheless, the fact remains that the resources do not belong to the developers; they belong to the people. This is the Panel’s viewpoint and the viewpoint of this report. We believe this viewpoint should also become part of the government and departmental culture with respect to this issue. That this is not the case was demonstrated several times at various points throughout the Panel’s analysis.

Over the past 60 years, strategic decisions were made in order to exploit the good fortune that we have as an energy province and those decisions shaped Alberta into the oasis of opportunity it is today. The royalty and tax regime recommended in this report, “Our Fair Share, Report of the Alberta Royalty Review Panel”, represent crucial interim steps toward a new Alberta – one energized by a compelling new understanding of what can be achieved financially and by visionary actions we take now on behalf of our grandchildren and yet-to-be born great-grandchildren.
Our Fair Share

We proudly and humbly submit this report with gratitude for the opportunity to serve our Province and, in this highly important and strategic arena, I believe this Panel has also served its country.

Regards,

(original signed by)
William M. Hunter
Chair
Alberta Royalty Review Panel

On behalf of the Panel

Panel Members:

Evan Chrapko
Judith Dwarkin
Ken McKenzie
André Plourde
Sam Spanglet
“Our Fair Share” Pembina Primer

The preceding letter was written by Bill Hunter, the Chair of the Royalty Review Panel assigned by the provincial government earlier this year to review and recommend changes to Alberta’s energy royalty regimes.

The government-appointed six-member panel is comprised of a former senior executive with an oil company, a chief economist for a Calgary-based energy research firm, two economics professors, a businessman and a forestry executive.

Here are some details on how the report came to be and some of the findings.

Who Owns the Resource?
Albertans are the owners of the oil sands, oil and gas resources in the province. The provincial government manages these resources on behalf of the owners.

The Manager’s Role
As manager, the government allows companies to undertake oil sands, oil and gas developments. Companies incur costs to develop the resources and obtain revenue from their sale. The government is responsible for obtaining a fair share of that revenue on behalf of the resource owners — the people of Alberta. It is the government’s duty as manager to maximize the value that Albertans receive from the development of their resource.

Calls for Royalty Reform
Before becoming Premier in 2006, Ed Stelmach committed to reviewing royalty rates for the oil sands as well as for conventional oil and natural gas. When he became Premier he tasked Minister of Finance Lyle Oberg with leading the review process.

In February 2007, the government of Alberta assigned an independent panel of experts to review and make recommendations on Alberta’s royalty and tax regimes. Its objective in conducting the review and making recommendations was to ensure that Albertans are receiving their fair share from energy developments. Beginning in April, the Royalty Review Panel held a series of public meetings in which individuals and stakeholders had the opportunity to provide input, information and data to the Panel on the province’s tax
and royalty regimes. In addition to collecting the input of individuals and stakeholders, the Panel was specifically asked to consider:

- How Alberta’s tax and royalty regimes compares with other jurisdictions.
- Whether Alberta’s tax and royalty regimes are sufficiently sensitive to market conditions.
- Whether the oil sands royalty regime is optimal.
- What components of the current regime should be retained or strengthened and which should be adapted or eliminated.
- The economic and fiscal impact of any changes to the tax and royalty regimes.
- How existing resource developments should be treated if changes are made to the existing tax and royalty regimes.

**Royalty Reform Recommended**

On September 18, the final report of the Royalty Review Panel was made public. After about seven months of research, analysis and input, the Panel concluded that Albertans “…do not receive their fair share from energy developments and they have not, in fact, been receiving their fair share for quite some time.”

According to the Panel “The royalty rates and formulas have not kept pace with changes in the resource base and world energy markets.” The Panel went on to say that the onus is now on the Alberta government to re-balance the royalty and tax system so that a fair share is collected. To that end, the Panel made a number of recommendations for reforming Alberta’s energy royalties to update what are now seriously outdated royalty regimes for oil, oil sands and natural gas. The recommendations are designed to ensure Albertans retain a greater share of revenues from the development of their resources while maintaining competitiveness with world energy investment opportunities. They are designed to be taken as a complete package and will position Alberta in the middle of the pack when compared with other relevant jurisdictions.

**Impact of the Recommendations**

If all the Panel’s recommendations are implemented, Albertan’s royalty revenues would increase 20%, approximately $2 billion annually, as the share of revenue received by Albertans increases.

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**Pembina Institute’s Work on Royalties**

The Pembina Institute has been working on this issue for a number of years beginning in 2003 when we secured funds to do a multi-jurisdiction review of oil and gas revenue capture regimes in western and northern Canada. In 2004 we released “When the Government is the Landlord” which compared the royalty regimes in British Columbia, Alberta, Saskatchewan, the Yukon Territory and the Northwest Territories with Alaska and Norway, regions known for obtaining higher revenues from non-renewable resource developments.

In 2005, the Pembina Institute completed a comprehensive analysis of government support for Canada’s oil and gas industry. This report estimated that government support to this industry was $1.2 billion in 2002.

In 2006, after securing additional funds to investigate the oil sands royalty regime, we began our “Thinking Like an Owner” series with the release of a report detailing the urgent need to review and reform Alberta’s oil sands royalty regime. The series continued with “A Blueprint for Royalty Reform” and finally “Royalty Reform Solutions”. The “Royalty Reform Solutions” report presented results of a detailed modelling exercise in which we demonstrated three alternative ways to reform Alberta’s oil sands royalty regime while maintaining the economic viability of oil sands projects. The Pembina Institute presented the results of this assessment to the Royalty Review Panel in May of this year.

**Support Growing for Royalty Reform**

Since the release of the report, support has been mounting in favour of royalty reform, as the excerpts and quotes below demonstrate:

From Canadian Press: *TD report says Alberta boom will continue to bloom, no bust in sight, September 27*

Re. TD report on Alberta “The Tiger that Roared Across Alberta”

“A provincially commissioned review of Alberta's royalty structure has called for a sharp increase in royalty payments, particularly from oilsands producers. While the TD report expects the government's response to that report to be "the next major event," it suggests that many of the review Panel's recommendations make economic sense.”

From Edmonton Journal: *Industry argument 'distorts picture'
Review panel says its conclusions based on sound data provided by oilpatch, September 27*

Re. Wood Mackenzie report “Fiscal impacts of proposed Alberta royalty regime changes”
“To bolster its argument that its proposals are globally reasonable, the panel pointed to a new report by Wood Mackenzie. It said that Alberta's oilsands regime is currently the world's 11th most financially attractive jurisdiction out of more than 100 analyzed, while it would become 44th-ranked if the report's recommendations, such as a new oilsands surtax and higher post-payout royalties, were fully implemented.”


“Beginning at least three years ago, the Department [of Energy] demonstrated that Alberta’s share had fallen below its target range. The Department estimates that it could collect an additional $1 billion or more per year without stifling industry profitability. However, neither this information nor the reasons why changes have not taken place have been made public.”

“Department technical review staff assures us that they have held the view that Alberta has not been collecting its appropriate share since 2000.”


“The low or very low government share [from oil sands] may be reasonable under conditions of low prices and high costs. However, it seems that there is considerable justification for establishing a higher share under conditions of high prices and low costs.”

“It should be noted that there are few development projects in the world with such high NPV10 [net present values with a discount rate of 10%] values, at any project size, at a WTI [West Texas Instrument] of US $60 per barrel. Large mine plus upgrading projects are therefore enormous long term value creators for the investors, once oil prices exceed $40 per barrel WTI and based on average or low costs.”

“The government could levy higher royalties under prices of US$50 or higher without creating unacceptable economic conditions for investors.”

“Royalties are very low under high cost conditions and current price expectations. This raises the issue whether it is in the interest of Alberta to continue to stimulate through the fiscal system such very high cost production ventures. Providing a fiscal disincentive for very high cost oil sands production ventures may assist in avoiding excessive cost escalation in the Alberta economy and thereby facilitating an environment for upgrading projects with higher value added opportunities.”
For more information …

**Royalty Review Panel’s Report**

Read the Royalty Review Panel report which is posted on the Panel’s website:

http://www.albertaroyaltyreview.ca/

and on the Alberta Finance Departments website:

http://www.finance.gov.ab.ca/whatsnew/index.html#royalty

**Pembina Reports**

Visit www.pembina.org and www.oilsandswatch.org

Here are links directly to the Pembina Institute’s reports on royalties:

- Presentation to the Royalty Reform Panel (2007)
  http://www.pembina.org/pub/1469

- Royalty Reform Solutions Fact Sheet (2007)
  http://www.pembina.org/pub/1460

  http://www.pembina.org/pub/1457

- Models for Oil Sands Royalty Reform (2007)
  http://www.pembina.org/pub/1461
Extracts from Media Articles

Sound Off! on the royalty review
Edmonton Journal, September 19, 2007
"The panel concluded that Albertans do not receive their fair share from energy development and they have not been receiving their fair share for some time," Hunter told reporters. "Royalty rates in Alberta have not kept pace with changes in the resource base, world energy market and conditions in other energy-rich jurisdictions."

Royalty review puts lie to pablum Ralph fed us
Edmonton Journal, September 19, 2007
“At 104 pages, the report is as hefty as a small phone book and contains more graphs than a math text but you don't need to read the whole thing to get to the punchline. You'll find it in the opening sentence: ‘Albertans do not receive their fair share from energy development.” – Graham Thompson

“By failing to keep pace, the Alberta government shortchanged us by $1.9 billion last year alone. Imagine how many interchanges we could have built with that or how many women's shelters we could have supported. And that's just one year.” – Graham Thompson

Confused energy investors not following script
It's darn hard to report on sector's royalty review meltdown when there isn't one
Edmonton Journal, September 25, 2007
“Stock prices tell a similar tale of woe. With project costs going through the roof, and industry profit margins being squeezed, shares of Canadian Natural Resources are up a piddly 50 per cent or so this year, and about 650 per cent over the past five years.” – Gary Lamphier

Deputy premier to hear oil industry concerns
Stelmach gov't gathers more feedback before October decision on royalty regime
Edmonton Journal, September 25, 2007
"But these are not government's resources. They are not industry's resources. They are the inheritance of all Albertans - the key to my province's future - and I must be guided by that." – Hon. Ed Stelmach

Oilpatch's tale of doom doesn't jell with economic reality: Even a royalty hike doesn't take Alberta out of contention as a place to invest
Edmonton Journal, September 27, 2007
“With the second-largest oil reserves on the planet, energy firms would be nuts not to invest in Alberta's oilsands. Especially when all upfront capital and operating costs -- plus a six-per-cent return on the dough invested -- must be recovered before they hit the current 25 per cent net revenue payout.” – Graham Thomson
**Auditor General’s Report**

Link to the most recent Auditor General Report:

**TD Economics Report**

Toronto Dominion Economics report entitled: The Tiger that Roared Across Alberta.
http://www.td.com/economics/special/db0907_alta_exec.pdf

**Wood Mackenzie Report**

http://www.woodmacresearch.com/cgi-bin/corp/portal/corp/corpPressDetail.jsp?oid=872279

**van Meurs report**

Energy analyst Pedro van Meurs conducted an analysis of the royalty system for the oil sands.

**Alberta Finance Contact Information**

Minister of Finance Lyle Oberg
Alberta Finance
Room 426, Terrace Building
9515 - 107 Street
Edmonton, Alberta, T5K 2C3
FAX: (780) 427-1147
strathmore.brooks@assembly.ab.ca

**Member of Legislative Assembly Contact Information**

MLA contact information is located at:
October 2, 2007

The Honourable Ed Stelmach
Premier of Alberta
Room 307, Legislature Building
10800 – 97th Avenue
Edmonton, AB  T5K 2B6

Re: Government of Alberta Response to Royalty Review Panel’s Recommendations

Dear Mr. Premier:

Our Fair Share, the report of Alberta’s Royalty Review Panel, presents a pivotal opportunity to begin aligning the province’s oil and gas royalty policies with the best interests of Albertans.

The conclusions of the Panel’s consultation process and the depth of its members’ expertise and research have clearly established the fact that, to quote the report, “…Albertans do not receive their fair share from energy development and they have not, in fact, been receiving their fair share for quite some time.” Government action is urgently called for in order to redress this imbalance.

Since the publication of When the Government is the Landlord in 2004, the Pembina Institute has drawn attention to government’s responsibility to “think like an owner” on behalf of Albertans and ensure that citizens obtain maximum benefit from the development and sale of the resources they own.

In our submission to the Panel in May of this year, the Institute presented detailed modelling results showing that owners can capture up to 70% of resource rents from oil sands projects, while maintaining competitive rates of return for developers.

In comparison, the Panel’s recommendations for increasing Albertans’ share are relatively modest. They would result in 64% of revenue being captured by governments on behalf of their citizens and would make Alberta an average performer – not a leader – when it comes to maximising revenue share. As you know, this would represent about $2 billion in additional annual royalties for Albertans.

Although the Panel’s proposals do not go as far as we had hoped, the Pembina Institute is prepared to support a government decision to implement the Panel’s full package of recommendations as an acceptable outcome of the review process.
Selective implementation of a few reforms, by contrast, would solidify Alberta’s position as a below-average performer on royalties. In this case, the review could only be seen as having failed Albertans.

As you take some time to reflect on your decision, industry is concertedly raising predictable objections to the *Our Fair Share* report. You should have no difficulty in seeing through these objections and remembering that your government’s first responsibility is to obtain maximum value on behalf of Albertans. The following frequently-cited criticisms are little more than fear tactics:

— *Capital costs are rising in the oil sands.* Capital expenditures have a bearing on pre-payout economics, when investment costs are being recovered. However, the Panel’s recommendations make minimal adjustments to the pre-payout fiscal regime. Notably, the 1% royalty rate remains unchanged, and there should be only minor impacts on whether or not a project is profitable. The primary intent of the reforms is to allow Albertans to retain a fair share of post-payout resource rents, and to benefit from windfall profits when oil prices rise.

— *Changes will create uncertainty.* As agents managing the oil sands resource on behalf of Albertans, the government has a responsibility to review and reform the royalty on a regular basis in response to changing priorities. In the case of the oil sands, the current generic regime was designed in the 1990s to promote a sector facing very uncertain prospects at the time. These difficulties no longer exist. It’s also important to note that the Panel’s recommendations have been predicted to transfer between $1 and $2 per barrel from developers to owners. These figures are small in comparison to uncertainties in oil prices (on the order of $30, $50 or even $70 per barrel) that companies plan for as a matter of course.

— *Existing operations should be exempted.* As the Panel rightly points out, “…it is not best practice for the Government of Alberta to accept something less than a ‘fair share’ simply because the rules currently in place might have represented a fair share a decade ago under very different conditions.”

— *Investors will flee Alberta.* Alberta remains a uniquely stable, democratic jurisdiction with easy access to the world’s single largest market for fossil fuels – the United States. Meanwhile, changes to the royalty regime would only serve to establish Alberta in an average position with regard to royalty rates. As was made public with the release of the Auditor General Annual Report earlier this week, the Department of Energy’s own royalty review concluded that royalties could be increased while maintaining industry profitability.
and capturing 66% of net revenues would be competitive with other regions in Western Canada and the United States.

Industry players have also implied that they deserve to have mechanisms for comment on the Our Fair Share report. This is wholly inappropriate. Energy sector stakeholders had ample opportunity to present their views and data as part of the Royalty Review Panel’s consultations. Not only did industry representatives make more than two thirds of the presentations heard across Alberta, Panel members brought their own considerable industry experience and expertise to the consultation and analysis.

However, should you decide to hold further consultations, it is only fair that they be held in a public forum, following the same principles as the Review Panel’s sessions. A decision of this magnitude and importance for Albertans must not be made behind closed doors.

Premier, the leadership opportunity presented by accepting and implementing the Panel’s full package of recommendations is a legacy defining moment. Your decision will either set Alberta on a course of long-term prosperity, or on a course in which we squander the value of our resource and the opportunity to invest in a sustainable economy.

As explained above, the Pembina Institute is prepared to fully support your decision to adopt the full package of recommendations prepared by the Royalty Review Panel. Should you wish to discuss further, I invite you or your staff to call me on my cell phone at any time: 403 607 9427.

Sincerely,

Marlo Raynolds

Executive Director
Pembina Institute
#200, 608 – 7th Street SW
Calgary, AB
T2P 1Z2

cc: Hon. Lyle Oberg, Minister of Finance
cc: Hon. Mel Knight, Minister of Energy
cc: Kevin Taft, Leader of the Official Opposition
cc: Brian Mason, Leader of the NDP