
# Thinking Like An OWNER

FACT SHEET

OVERHAULING THE ROYALTY AND TAX TREATMENT OF ALBERTA'S OIL SANDS

# Royalty Reform Solutions

## THREE WAYS TO ENSURE A FAIR SHARE OF OIL SANDS REVENUES FOR ALBERTANS, THE OWNERS

***Albertans are losing billions of dollars in oil sands royalties due to an outdated royalty scheme that was designed to stimulate a fledgling oil sands industry, rather than maximize returns for Albertans.***

In fact, the plan to stimulate the development of the oil sands industry was so successful that oil sands production in Alberta reached the 2020 goal of producing more than one million barrels of oil per day in 2004, a full 16 years ahead of schedule.

While oil sands companies are reporting record profits, the Alberta government's 2007 budget predicted a decline in oil sands revenues to Albertans within three years. The Alberta Department of Energy predicts oil sands revenues will be the same in 2020 as they were in 2004 / 2005, despite a projected tripling of production over that period.

How bad is it? Today, Albertans receive only 32% of the net revenue available from oil sands development through taxes and royalties while the companies take 53%. The federal government obtains the remainder of the revenue through income taxes.

Compare this to Norway – considered a leader in managing oil and gas development on behalf of its citizens – where companies retain 22% of available revenue and 78% of net revenue is captured for Norwegians, the owners of the resource.

It is time for the Alberta government to come to terms with its responsibility of managing oil sands investments on behalf of its citizens. The Pembina Institute has investigated three ways to deliver a fair share of oil sands revenues to Albertans, the resource owners. Each of these options strikes an important balance between ensuring a reasonable return for companies and maximizing earnings to Albertans for the one-time development of their non-renewable resource.

**A fair share royalty reform could generate $7 to $29 billion more revenue for each oil sands project for Albertans, the owners of the resource.**

COMPOSITE PHOTOS: DAVID DODGE & GORDON HOWELL

## Royalty Reform Solutions – JUST THE FACTS

### Origins of the Royalty Regime

- *The Alberta government established the oil sands royalty regime in 1997 to accelerate oil sands developments beyond 1 million barrels/day by 2020.*
- *Extremely low royalties (25%) worked to overcome barriers related to high capital costs and encourage the large investments needed to develop the oil sands.*

### Rising Oil Sands Production

- *Since 1997, capital investments in oil sands projects have increased more than 400%; oil production has increased 130% and the price of bitumen has increased 256%.*
- *The production goal of 1 million barrels of oil/day from the oil sands was surpassed in 2004, 16 years ahead of schedule.*

### Declining Resource Revenues

- *The provincial government predicts that resource revenues will decline within three years, partly due to the low royalty rates applied to oil sands developments.*
- *Oil sands royalty revenue is predicted to be the same in 2020 as it was in 2004/2005 despite a tripling of production by that time.*

### Ensuring a Fair Share?

- *The current royalty regime leaves 53% of net revenue with companies while Albertans retain only 32% of the revenue available from oil sands developments.*
- *Companies undertaking oil and gas developments in Norway retain 22% of the revenue, while Norwegian citizens – the owners of the resource – receive 78% in revenues.*
- *90% of Albertans indicated in a recent poll that Alberta should be a leader in maximizing resource value for its citizens.*

### Striking a Balance

- *Restructuring the royalty regime to reflect current economic realities would enable Albertans to earn higher resource revenues while still enabling companies to obtain a fair return on their investments.*

Oil SANDS Fever SERIES

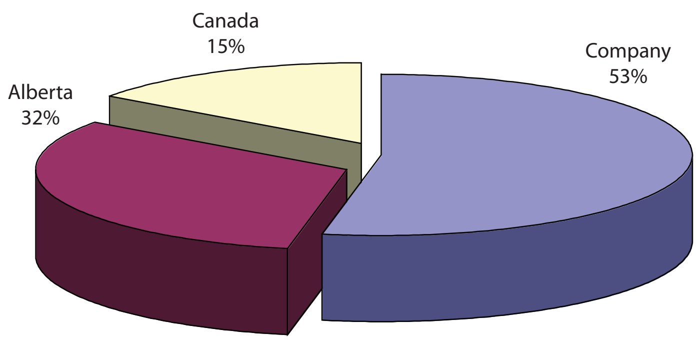


# Oil Sands Royalty Reform

## THE STATUS QUO:

***Under the current oil sands royalty regime, companies retain 53% of the available revenue, the federal government receives 15% in taxes, and the provincial government – on behalf of Albertans – receives 32% of available revenues through royalties and taxes.***

***The status quo royalty scheme places a 1% royalty on gross revenue from oil sands projects until companies have recovered all of their costs including a return allowance or, in other words, until projects are turning a profit. At that time, the royalty increases, but only to 25% of net revenues.***




◄ *Figure 1: Distribution of the total net revenue of an oil sands project under the current royalty regime.*

# A Fair Share for Albertans: 3 Options

To explore the implications of different royalty structures for citizens and companies, the Pembina Institute developed "net cash flow" models of typical mining and in situ oil sands projects, and then analyzed three alternative royalty options.

To understand the impact of each royalty reform option, we examined the annual flow of revenue from the project developer to:

1) the federal government through taxes,

2) the provincial government through taxes and royalties.

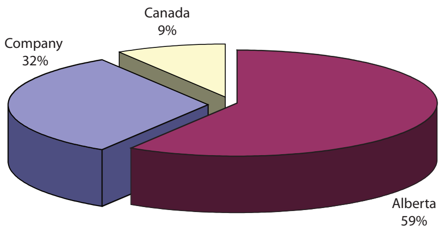
In addition, we examined the Internal Rate of Return (IRR) that developers would receive under each of the options. This rate of return is a key factor influencing investment decisions for companies.

If you think of oil sands companies as resource developers working on behalf of citizens, their share of the profits equates to a commission for developing Albertan's resources. The Pembina Institute's analysis suggests that around 30% is an appropriate commission rate for resource developers. At this level, the internal rate of return on oil sands investments continue to be unequivocally attractive for resource developers under a variety of different royalty structures (23% to 26% for in situ projects and 12% to 15% for mining projects), while still delivering a fair share of the revenues to citizens.

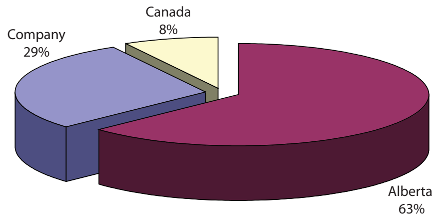
At this level of commission, around 70% of the available resource revenue would be retained by governments (federal and provincial) on behalf of Albertans and Canadians.

# Solutions: A Fair Share for Albertans

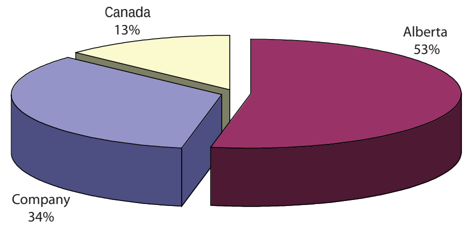
## HIGH COMMISSIONS FOR RESOURCE DEVELOPERS




▲ *Figure 2: Distribution of total net revenue from an oil sands project with 55% royalty on net revenue.*




▲ *Figure 3: Distribution of total net revenue from an oil sands project with tiered royalty.*




▲ *Figure 4: Distribution of total net revenue from an oil sands project with polluter pays reform.*

### 55% Net Royalty

One option for reforming the royalty structure is to leave the 1% royalty alone – since raising the royalty above 1% would only delay the time required for companies to turn a profit and pay the higher royalty rate – but to raise the second tier royalty rate on net revenue from 25% to 55%.

Increasing the royalty to 55% would still ensure a reasonable IRR for companies, while delivering a fair share of the revenues to Albertans as the owners of the resource. When combined with tax revenues, the Alberta government would receive approximately 59% of the available revenues and the federal government would receive 9%. Companies would still receive 32% of the available revenue.

A 55% royalty would be good news for Albertans: over the life of an average in situ project, the increase would mean an additional $9 billion dollars to Albertans. And that's just for one project! Nor are the benefits one-sided, as the company developing the project would still realize a 26% IRR on their investment. An additional $25 billion would be received over the life of a typical mining project while the IRR for mining companies under this reform option would be 15%.

### 3-Tiered Royalty

A second strategy would be to implement a three-tiered royalty structure. A company would pay a minimum 1% royalty on gross revenue, a 30% royalty on net revenue once they have recovered all of their costs (including the existing return allowance), and then a 60% royalty on net revenue once the company's profits exceed a specified threshold (the existing return allowance plus 10%).

Implementing the three-tiered royalty structure would increase Albertan's net revenue share from 32% to approximately 63% – while still delivering a commission of 29% to companies for developing the resource. On a per project basis, this would deliver an additional $10.6 billion dollars in royalties from each in situ oil sands project and an additional $29 billion dollars in royalties from each oil sands mining project. Under this reform option, the IRR would still be above the 12% threshold, at 25% for in situ and 14% for mining.

### Polluter Pays

The third option for royalty reform combines increased royalties with an environmental levy based on the polluter pays principle. Under this option, companies pay an environmental levy of $40 per tonne of carbon dioxide emissions in addition to royalties set at 1% of gross revenue (paid until all costs and a return allowance are recovered) and 40% of net revenue.

In this scenario, Alberta receives approximately 47% of available revenue while the federal government receives 15% through taxes. Companies would retain approximately 38% of the available revenues.

Over the life of an oil sands project, the polluter pays option would deliver an additional $7 billion dollars in revenue from each in situ oil sands project and an additional $23 billion for each mining project for Albertans. The internal rate of return for resource developers would be 23% for an in situ project and 12% for a mining project.

*Composite photo of oil sands mining and photo voltaic installation.* ▶

PHOTOS: DAVID DODGE & GORDON HOWELL

▲ *Syncrude oil sands mine and wind farm in southern Alberta.*



PHOTOS: DAVID DODGE, THE PEMBINA INSTITUTE

# The Fair Share Solution

## *Non-Renewable Resource Revenues Should be Invested for the Future*

Beyond establishing a royalty system to ensure a reasonable return for companies developing the oil sands and a fair share of revenue for Albertans as the owners of the resource, the important question remains of what should be done with the revenue earned from the development of the publicly owned, non-renewable resource.

The Pembina Institute recommends that the Government of Alberta invest 50% of the revenues it obtains from the oil sands into a long term fund. The fund would enable the government to save for future generations, protect Albertans from economic boom and bust cycles and transition to a more sustainable economy that uses renewable sources.

▲ *Suncor's flare is visible over the oil sands mining tailings ponds at dusk.*

PHOTO: DAVID DODGE, THE PEMBINA INSTITUTE

A fair share solution will ensure responsible development of the oil sands and ensure revenues from non-renewable resources are invested to create a sustainable energy future.

Economic conditions are dramatically different today than they were in 1997 when the government introduced the low royalty structure for oil sands to encourage the growth of the fledgling oil sands industry. Today – set against a backdrop of record profits for oil sands companies – the economy is overheated, costs are rising and the development of critical infrastructure such as schools and roads is lagging. Moreover, oil sands developments are outpacing the government's ability to responsibly address related environmental impacts, leaving Albertans with a legacy of environmental pollution. The current royalty regime is failing to encourage responsible development of the oil sands and it is failing to deliver a fair share of resource revenues to Albertans, the owners of the resource.

Yet, a win-win royalty regime is possible. **The Pembina Institute recommends that the oil sands royalty regime be reformed such that governments capture 70% of available revenue through taxes and royalties.** This can be done while maintaining an internal rate of return for companies that is greater than 12%. Changes should be made for new projects, including those currently in the approval process, immediately and phased in for old projects over time. **The Pembina Institute also recommends that at least 50% of resource revenues from the oil sands be placed into a long term fund** to be used to cushion the Alberta economy from boom and bust cycles, as a store of wealth for future generations and to facilitate a transition to a sustainable energy future for Alberta.

## Want more information?

*For more information, download our full report by Amy Taylor,* ***Royalty Reform Solutions****, from* ***www.oilsandswatch.org****. Access the full report, additional* ***Thinking Like An Owner*** *fact sheets, as well as photos, videos, slide shows and other information and our Oil Sands Fever series of reports on oil sands development.*

*Please consider making a donation to support our work on royalties and the environmental impacts of oil sands development. For more information or to make a donation please visit:* ***www.pembina.org/donate****.*

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Sustainable Energy Solutions