Presentation to the Oil Sands Multi-stakeholder Committee
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Mr. Chairman and Members of the Panel:
The Pembina Institute is pleased that the government has invited Albertans to provide their vision and principles to guide how oil sands developments in the province should proceed.
The Pembina Institute has a vision for oil sands in Alberta. That vision, is that:

Development of the oil sands occurs at a pace and scale that:

- *respects the capacity of regional ecosystems to be sustained,*
- *addresses global climate change by achieving deep reductions in greenhouse gas emissions towards a net-zero emissions target,*
- *optimizes financial benefit to the owners of the resource, and*
- *continuously improves the quality of life of all Albertans today and for future generations.*

A number of principles are needed to achieve this vision. My colleagues have spoken to several of these principles over the course of this public consultation process. The one that I will be discussing today is the following:

> A fair royalty regime so that Albertans are adequately compensated for the development of the oil sands resource.

This means a royalty regime that achieves a win-win for companies and Albertans where companies are able to retain a fair return on their investment and the balance of the value of the resource goes to Albertans. After all, it is the people of Alberta that own the oil sands resource.[1] The government of Alberta, through the Department of Energy manages the resource for the citizens.[2] As resource manager, the government allows companies to develop the oil sands resource. These companies incur development costs and if they are successful and produce oil, they also receive revenue from its sale. The government is then responsible for ensuring that an appropriate portion of the revenue from the sale of the oil goes to the citizens of Alberta as resource owners.

[1] A portion of oil and gas resources are privately (rather than publicly) owned. For privately owned resources, royalties are paid to individual landlords. This research project is concerned with publicly owned oil sands resources.

[2] Only 2.6% of the area covered by oil sands are privately owned. The rest are on public lands and as such are owned by all the citizens of the province. Source: Alberta Energy, personal communication, September 2005.

The government collects the revenue through royalties and lease sales. The royalty rates and the amount of revenue collected through sales need to ensure that the companies retain a fair return on their investment and other revenues are returned to the citizens of the province. When governments set royalties too low, do not obtain sufficient revenue through lease sales or offer significant royalty breaks (in the form of credits, exemptions, rebates), the government is short-changing the rightful owners of the resource. The government is short-changing Albertans.

Unfortunately, in the case of Alberta's oil sands, the low royalty rates currently in place mean that industry is getting more than its fair share. Instead of a win-win in which companies make a fair return on their investments and the citizens acquire maximum value for their resource, today we have a win-lose system where the interests of oil corporations are trumping those of Alberta citizens.

The current royalty regime was established to provide incentive for capital investments and to spur oil sands developments by requiring minimal royalties until all costs have been recovered as well as a return on investment. The royalty rate then increases, but only to 25% of net revenues.
The trend in capital expenditures and production since the royalty regime was introduced, demonstrates the effectiveness of this policy at overcoming barriers related to high capital investments. Between 1997 and 2005, capital expenditure on oil sands increased from $2 billion (2000$) to $8.7 billion (2000$)-an increase of over 300%. Over the same time period, oil sands production increased 88%.

The current royalty regime has accomplished and even exceeded its objectives of spurring oil sands developments. In addition to significant increases in capital investments and production, the price of oil has also increased substantially since the generic royalty regime for oil sands was established.
In fact, the most important economic factor for oil sands projects is the price of oil. With the developments of new processes and technologies, oil prices need to be above about US $25 to $30 per barrel for oil sands operations to be economically viable.[3]

Between 1995 and 2005 the global price of oil increased by 214%. In 2005, the average price of oil was over $56/barrel (US$ West Texas Intermediate) and in 2006 a new record of over $77/barrel (US$ West Texas Intermediate) was reached. The price of oil is now well above the US $25 per barrel of the mid-1990s.

The generic royalty regime for oil sands has facilitated massive capital investments and increases in production. At the same time, technological improvements have occurred and the price for oil has increased significantly.
Oil sands developments are no longer considered a marginal resource with underlying technological and economic disadvantages. They are seen as a knowledge-based, technology driven resource of

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[3] Mawdsley, John, Jenny Mikhareva and Joel Tennisa, *The Oil Sands of Canada, The World Wakes Up: First to Peak Oil, Second to the Oil Sands of Canada,* (Calgary, Alberta: Raymond James, July 28, 2005).

substantial quality and value. The production industry is now well established on a commercial scale.[4] Despite this shift in the oil sands industry from fledgling to mature as well as the drastic increase in the price of oil, the provincial government has maintained the same royalty regime. The royalty regime has not been adjusted to reflect today's economic reality. The result is declining royalty revenue for each barrel of oil from oil sands. Albertans received less royalty revenue for each barrel of oil from oil sands in 2005 than they did in 1997. Between 1997 and 2005, royalty revenue per barrel of oil declined by 39% from $2.85 to $1.74.

The decline in royalty revenue is likely a result of the significant increases in capital expenditure taking place and a major factor in that regard is cost over-runs. The cost over-runs, a result of the unsustainable pace of oil sands developments and an over-heated provincial economy, mean that companies are spending longer time at the low royalty rate instead of jumping to the 25% royalty rate. The result is lower royalties today and deferred royalties tomorrow.

The royalty applied to the oil sands is called a resource rent royalty. Because resource rent royalties are levied on net revenues and thus take into account the cost of resource production, they can be set higher than royalties which are based on gross revenues and do not take costs into consideration. Royalties on gross revenues apply to natural gas and conventional oil in Alberta.

In the case of Alberta's oil sands, the resource rent royalty rate (25% of net revenue) is set below that which applies to conventional oil (up to 40% of gross revenue) and natural gas (up to 35% of gross revenue) in the province. This exceedingly low royalty rate means that companies operating in the oil sands are reaping excess profits at the expense of the real owners of the resource-Albertans.

As conditions change, so too should fiscal policy. It is irresponsible to keep royalty regimes stagnant in the face of increasing oil prices, technological improvements and massive capital investments. While the low royalty rates may have been justified in the early days of oil sands developments, they are no longer needed.

The royalty regime applicable to Alberta's oil sands needs to be adjusted to reflect today's economic reality and ensure that the citizens of the Alberta are obtaining maximum revenue from the development of their non-renewable resource. Leaving excess profits in the hands of multi-national corporations is not in the best interest of Albertans. The royalty regime needs to be adjusted to ensure a "win-win" occurs for companies and citizens and not a "win-lose" where the interests of the corporations take precedence and the citizens are short-changed for the depletion of their resource.

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[4] Yildirim, Erdal, *Oil Sands Developments in Canada,* (Edmonton, Alberta: UNITAR Centre for Heavy Crude and Tar Sands, No. 1998.227, 1998).

The government of Alberta needs to conduct a comprehensive and public review of the oil sands royalty regime and increase the royalty rates accordingly.[5]

Support for such a review is growing. A recent poll revealed that 63% of Albertans feel they are not getting maximum revenue from oil sands developments and 84% of Albertans support a public review of the royalty regime.[6]

Changes to the tax and royalty regime can be made without significantly lowering investor confidence. Government leaders need to take a long term approach to resource developments and recognize that despite threats by corporations to reduce investments in the oil sands if fiscal policies are changed, they are unlikely to walk away from the second largest oil deposit in the world. To allow companies to adjust to a new royalty regime, changes should be announced in advance of implementation and undertaken in a time defined manner. Changes should be made for all new projects right away and changes to old projects should be phased in over a period of time with the details well known in advance of implementation.

In summary, the Pembina Institute has a vision for the development of the oil sands. That vision is that the oil sands are developed at a pace and scale that (among other factors) optimizes financial benefit to the public owners of the resource. This means a fair royalty regime that adequately compensates the people of Alberta for the development of the oil sands resource. To implement this vision, the following actions are needed:

1. The **Alberta Minister of Energy needs to increase the royalty rates** applicable to the oil sands sector.
2. The new **rates should be determined through a comprehensive and public review** and should be set to ensure maximum compensation to the citizens of Alberta.
3. Changes to the **royalty rates should be applicable to new projects immediately** and older projects over time according to a defined and well communicated timeline.
4. **Alberta Energy should suspend new tenure allocations and the Energy and Utilities Board and Alberta Environment should suspend new project approvals** until the review has been completed and the royalty rates have been increased to ensure that they apply to all new projects.

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[5] A tiered resource rent royalty that involves higher royalty rates at various return levels would ensure higher compensation for Albertans. Through such a regime, when company returns reach pre-determined thresholds, the royalty rate increases. The base royalty should be set at no less than that applied to conventional oil (i.e. it would be higher than 25%) and would increase as different thresholds of returns are achieved. For example, the royalty rate might begin at 35% with a return allowance of the LTBR, but if a return of the LTBR plus 10% was achieved, the royalty rate would increase, from 35% to 45%. If LTBR plus 20% was achieved, the royalty rate would increase again, to 55%.

[6] "Albertans Perceptions of Oil Sands Development Poll, Part 1: Economic Issues" (Calgary, Alberta: Pembina Institute, May 30, 2006, http://www.oilsandswatch.org/pubs-poll.php).