

Alberta In Situ Oil Sands Alliance

October 11, 2007

Dear Premier Stelmach:

Re: Royalty Review Recommendations

A Voice from Albertans

The Alberta In Situ Oil Sands Alliance (IOSA) represents a group of independent, Alberta-based emerging oil sands operators who have made substantial investments in the province. **We are Albertans who live, work, and invest in this province. We are investing in the future of Alberta and are a significant contributor to the economy. While royalties are important, a focus on royalties alone, in isolation from the employment, income tax and other direct and indirect benefits to Albertans from our investment, would not be appropriate.**

- Collectively, we have invested in over 500,000 hectares of oil sands leases. This has generated more than \$300 million dollars of bonus revenue for the province.
- Total recoverable resources for the members of the Alliance amounts to approximately 13 billion barrels.
- Collective estimated capital expenditure thus far is in excess of \$2.5 billion, and we are anticipating investing in the range of \$7 billion over the next five years to develop the resource for the benefit of Albertans.
- Developing these resources will generate significant direct and indirect employment throughout Alberta and Canada. As a group of producers, we will employ over 1,500 Albertans during our upcoming winter programs and estimate that during peak drilling and construction times we will collectively hire over 20,000 people. This creates significant opportunity and jobs across Alberta, including Aboriginal and rural communities.
- 80% of the province's oil sands resource is accessible only using in situ techniques. In situ projects require substantial technology and innovation to develop. As independent producers, we are investing in new technologies to reduce operating and capital costs and to protect the environment. This investment attracts the best and the brightest, strengthening Alberta's ability to continue to be a world leader in this technology.

Investment, and the contribution to a strong, vibrant Alberta, is at risk. It is imperative that we work together to foster a better understanding of the implications that the framework proposed by the Alberta Royalty Review Panel (the "Panel") will have on local, Alberta-based businesses. As Albertans, we are concerned about the jobs, and provincial revenues that may be lost if the recommendations of the report are implemented.

Response to the Report: Outdated Input and Incorrect Conclusions

The conclusions in the report are based on information that does not accurately represent today's oil sands environment. We would like to draw attention to some key areas and their implications to ensure that policy is set utilizing relevant, realistic information.

- **Outdated Cost Data**: The cost estimates utilized to develop the Panel's recommendations are not accurate. Our industry, like commodity-based industries throughout the world, has experienced substantial cost escalation. While the report uses capital estimates of \$18,300 per flowing barrel, actual costs in the Athabasca region are closer to \$29,000 per flowing barrel, more than 55% higher than the Panel's outdated estimates. The Panel's proposed new royalty policy is based on economic calculations using unrealistically low costs resulting in incorrect conclusions and recommendations that, if implemented, will damage Alberta's economy. Any calculation of Albertans' fair share must properly quantify the true costs associated with these complex, capital intensive projects, including Crown bonus payments, which have generated billions of dollars for Albertans.
- **International Comparisons are Misleading**: The Panel has compared the "relative take" of the government in Alberta to other regions internationally in order to justify changing the current regime. Clearly, there is no take for Albertans if the resource is not developed. To accurately set a benchmark for comparison, regions must be similar in their structural make-up. This is not the case in the comparison made by the Panel. In our view, it is important to consider the main criteria used by investors, such as internal rate of return (IRR) and net present value (NPV) of future net cash flows. IRR and NPV for oil sands projects are directly impacted by the quality of the resource, which requires large up-front capital investment and high ongoing operating costs. Without considering factors such as these, the royalty regime cannot maintain a fair sharing of the benefits of development between the resource owner and the risk taker. An undeveloped resource benefits no one. We encourage government to take all factors into account and conduct a more comprehensive comparison when assessing the regime in order to ensure that our oil sands resource is developed for the benefit of Albertans.
- **Economic Risk**: The report does not capture the true economic risk behind in situ oil sands projects. The average project will take between 7 to 10 years to fully develop, requiring substantial long-term investment. This timeframe requires a stable investment climate and a robust royalty regime that allows sustained investment to continue. Implementation of an Oil Sands Severance Tax (OSST) combined with a high net royalty (i.e. 25% to 33%) discourages the investment that is critical to these developments.
- **Access to Capital**: Capital is portable and moves to those jurisdictions that offer sustained returns. The large amounts of capital required to develop Alberta's oil sands resource is not available in Alberta – it must be sourced from international investors. As local Alberta-based operators we require a reasonable rate of return in order to finance on-going development. The proposed royalty changes lower the rate of return on many new projects making access to capital difficult. International investment benefits all Albertans – we cannot take this investment for granted. It is a key to the sustainable development and health of Alberta's economy.

Develop a Framework that Supports Local Alberta-Based Operators

A workable solution for all stakeholders is achievable and we suggest a royalty regime should be developed based on the following key points.

- **Ability To Pay**
 - Retain a net profit structure which allows for risk-taking by companies and a balanced share of profits with Albertans.
 - Eliminate the OSST. This tax is regressive, giving no consideration to cost and is discriminatory in its application. Implementation of this tax will disadvantage Alberta.
- **Share In The Upside**
 - Adopt a scaled royalty rate increase based on oil and gas prices above the break-even price for new projects.
 - Maintain a climate that fosters innovation in technology and promotes the exploration and development of new reserves. These projects reap a long-term reward for Albertans as a result of technological innovation.
- **Current Costs and Rates of Return**
 - Realistic costs and projections must be used. Rates of return need to be acceptable to allow new projects to attract capital necessary to develop Alberta's resources.
- **Maintain the Current Lease Tenure Approach**
 - Highly complex oil sands resource plays take significant amounts of time and capital to develop. Leaving the current timeframe of 15 years in place allows in situ producers to advance these complex projects and develop new technological advancements that maintain Alberta's leadership in the development of this type of resource.
- **Grandfathering of Royalty Changes**
 - The billions of dollars that have been invested in recent years for Crown oil sands leases and their development have been premised on the existing royalty regime and Alberta's expressed commitment to fairness and stability. All current and future projects on existing leases should be treated equally and any significant change of the rules in the middle of the game is, quite simply, wrong.
- **The Complete Picture**
 - When considering Alberta's fair share, one must include all the benefits enjoyed by Albertans from the development of our resources. An inappropriate increase in royalties will decrease investment, substantially decreasing employment, lease bonus payments, and income tax receipts for our province. A more complete assessment of the unintended consequences of royalty changes is needed.

Please contact any of the representatives listed on this letter to discuss our views of the implications of the report on the in situ operators of Alberta.

Alberta In Situ Oil Sands Alliance (IOSA)

Respectfully,



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