

**Syncrude Canada Ltd.**  
**Submission to Alberta Royalty Review Committee**

**Supplementary Information on Royalty Calculation Method:**  
***Bitumen vs. Upgraded Synthetic Crude Oil***

**20 June 2007**

**Historical Background**

- Prior to the implementation of Alberta's generic royalty regime for oil sands in 1996, integrated projects, (that is, oil sands projects that mine oil sand, extract the bitumen and upgrade the bitumen into synthetic crude oil) did not have the option to choose between royalties based on either bitumen or upgraded crude oil. The royalty was payable on the final product produced.
- As part of the National Oil Sands Task Force process, it was recognized, as a matter of principle, that royalties from oil sands production should be payable on the resource, which in this case is bitumen.
- New integrated oil sands projects that are developed under the generic royalty regime have the option to choose between a bitumen-based royalty or a synthetic crude oil-based royalty system. In fact, Albian Sands, CNRL and other integrated projects had this choice.
- In order to have a level playing field with new oil sands developers, the two operations that existed prior to the implementation of the generic regime, Suncor and Syncrude, were given the option to convert to a bitumen-based royalty upon development and adoption of an acceptable Bitumen Valuation Methodology (BVM).
- Industry and the Province (through the Department of Energy) are working towards the development and adoption of a final BVM; meanwhile, an interim BVM is in place and is used for royalty calculations by Albian Sands and Suncor (Firebag bitumen).
- Upon implementation of the final BVM, Syncrude will determine whether or not it wishes to exercise the option to convert to a bitumen-based royalty.
- If Syncrude chooses to convert to a bitumen-based royalty, the Province will re-capture royalties that were previously written-off as an eligible expense as part of Syncrude's Stage 3 upgrader expansion. This royalty re-capture will be based on an agreed amortization methodology.

### **Key Issues and Arguments**

**The resource is bitumen.** That's what Albertans own; therefore bitumen is what royalties should be based on. This was a basic principle of the generic oil sand royalty regulation, which set out to create a level playing field and encourage oil sand development.

**The price of bitumen is set by the market.** There *is* a market for bitumen, and it is growing. The province has already declared its strategy to grow the heavy oil industry and to keep any value-added work, such as upgrading, within Alberta.

**There is an interim Bitumen Valuation Methodology (BVM) in place today.** Albian Sands and Suncor's Firebag Project pay royalties based on this methodology. The current methodology derives the price of Athabasca bitumen based on the price of Cold Lake bitumen, adjusted for transportation and quality (Athabasca bitumen is of lower quality).

**The Department of Energy is proposing to change the BVM to a methodology that assigns bitumen value based on the price of synthetic crude oil (SCO) minus the upgrading cost-of-service.**

Syncrude asserts that the back-calculation of bitumen price from SCO price is unfair and could provide multiple values for the same quality bitumen depending upon:

- (1) Upgrading configuration (delayed coking based, fluid coking based, hydro processing based). An upgrader's capital and operating cost structure varies according to the configuration.
- (2) The cost of capital of the individual company. Since the cost of service calculation will differ from company to company, different bitumen values would be derived. This would result in companies paying different royalties on essentially the same product.

**Using SCO price minus Upgrading costs to arrive at the bitumen price would discourage investment in upgrading in Alberta.** Most developers would not build an Upgrader in a jurisdiction where the Crown applies royalty to the value addition, when it could be built elsewhere with no such tax.

**If the Crown were to back-calculate the price of bitumen based on a generic upgrader cost of service, this would effectively anchor the bitumen price at a fixed fraction of SCO price.** It would seem short sighted for the Province to pin itself to a fixed margin, when the long term strategy to grow value-add in Alberta should be expected to shrink the margin between light and heavy oil. Even though the bitumen resource is vast, the cheapest bitumen is being extracted first, so future bitumen capital will rely on upgrader thirst to pull bitumen price upward.

**CAPP, on behalf of industry, has proposed a BVM** that uses Western Canada Select (WCS), a widely traded heavy crude with 250,000Bbbls/Day volume and growing. The concept revolves around the amount of diluent that would need to be added to bitumen to give it the same density as WCS, and the type of diluent used (Condensate or SCO). Syncrude supports this proposal, given that all of these factors can be consistently and fairly valued amongst different producers.