

Suncor Energy Inc.
Written Submission
Alberta Royalty Review Panel
June 1, 2007

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- This submission contains certain forward-looking statements, including statements about Suncor's growth strategy and expected future production, operating and financial results that are based on Suncor's current expectations and assumptions. The forward-looking statements, identified by words and phrases such as "may", "continued to", "plans", "projected", "could" and "believes" are not guarantees of future performance. Actual results may differ materially as a result of risks, uncertainties and other factors, such as changes in general economic, market, regulatory and business conditions; fluctuations in commodity prices and currency exchange rates; the successful and timely implementation of capital projects; the accuracy of cost estimates and uncertainties resulting from potential delays or changes in plans, among others. See Suncor's current Annual Report and other documents Suncor files with securities regulatory authorities for further details, copies of which are available from the company. The forward-looking statements speak only as of the date hereof and Suncor undertakes no duty to update these statements to reflect subsequent changes in assumptions (or the trends or factors underlying them) or actual events or experience.
- Certain financial measures referred to in this submission, namely return on capital employed (ROCE) and cash flow from operations, are not prescribed by Canadian generally accepted accounting principles (GAAP). For a reconciliation, see pages 58, 76 and 77 of Suncor's 2006 Annual Report.

Introduction

Suncor Energy Inc. is an integrated energy company strategically focused on developing one of the world's largest petroleum resource basins – Canada's Athabasca oil sands. In 1967, Suncor made history by pioneering commercial crude oil production from the oil sands. Since then, Suncor has become a major North American energy producer and marketer, having produced over a billion barrels from our operations.

Today, our company has three major business divisions in Canada and the United States, with more than 5,500 employees. We support our core oil sands operations with conventional natural gas production in Western Canada. The company also has renewable wind energy and bio-fuels projects, in addition to downstream refining, marketing and retail operations in Ontario and Colorado. Suncor's integrated growth strategy is combined with a broad and long-term vision of sustainability that recognizes the importance of social and environmental performance.

This submission will address the oil sands portion of the Alberta Royalty Review. Suncor has participated extensively with the provincial and federal government in the past development of fiscal policy related to this resource. This, together with our 40 years of oil sands operations, gives us a unique perspective from which to share a number of points with the panel.

Suncor's position with respect to the generic oil sands royalty regime is as follows:

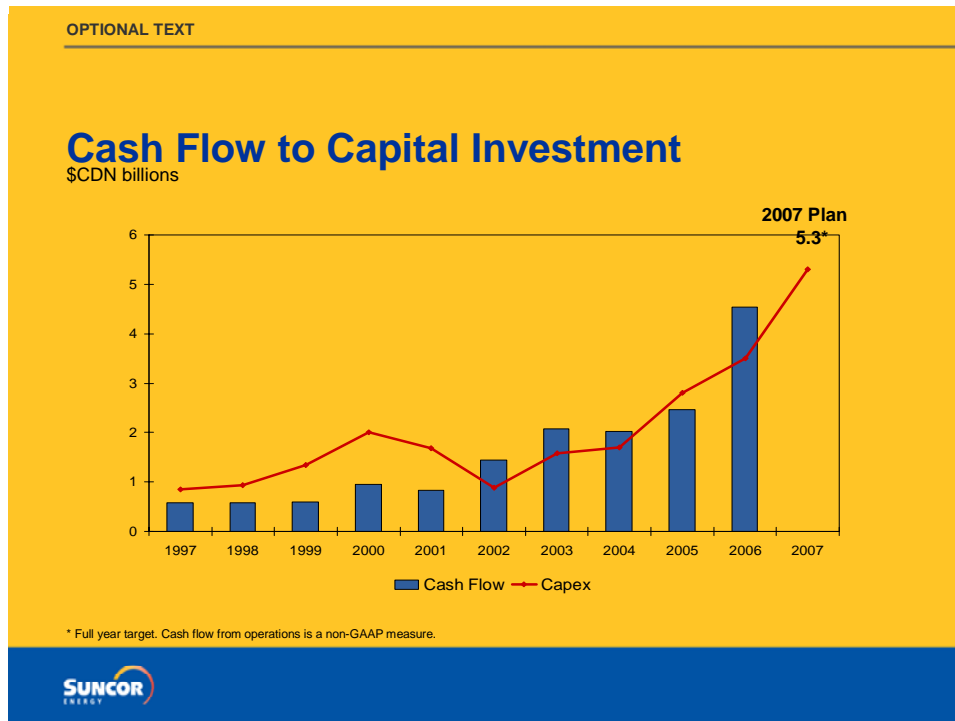
- it has been and remains appropriate, fair and competitive
- the generic regime is specifically structured to derive a reasonable economic rent from project-based oil sands developments for the citizens of Alberta, while timing payment to recognize the long lead times and billions of dollars developers put at risk
- the regime recognizes the fundamental differences in the investment and risk profile of oil sands versus conventional oil and gas production in Alberta
- it is globally competitive for similar world scale resource developments, and
- it has provided the same treatment for all oil sands developers

Since the introduction of the generic regime, Suncor and other oil sands operators have significantly expanded the scope and scale of oil sands development. However, the oil sands is still a relatively young and developing industry. It is only in the last 10 to 12 years that the industry became viable, largely as a result of changes in technology and implementation of the generic royalty regime (see Appendix – A Historic Perspective on Oil Sands development).

Recognizing the inherent risks and difficulties in developing the oil sands, in 1996 the National Oil Sands Task Force (NOSTF) recommended changing the fiscal regime. The generic regime, introduced in 1997, reduced the royalty rates, moving to a bitumen-based royalty. This leveled the playing field for all new entrants, provided upfront risk-sharing with developers and broadened the tax and royalty base by encouraging commercial development. In 2006, Suncor paid almost \$1 billion in oil sands royalties to Alberta and \$1.7 billion in total tax and royalties on earnings of \$3 billion. This shows that the Alberta Royalty Regime for a developed project, which has paid out, provides a significant return to Albertans even when prices are high.

Nonetheless even with the generic fiscal regime, oil sands development remains extremely challenging. High cost structures and production reliability are on-going issues and

technology is still being developed and refined to improve competitiveness and reduce the industry's environmental footprint. Despite these challenges, Suncor has demonstrated its commitment to re-investing in oil sands development. For the last nine years, we have re-invested approximately 100 percent of cash flow back into our business.



*Full year target. Cash flow from operations is a non-GAAP measure. For further information see Suncor's 2006 Annual Report, pg. 58.

In addition to funding expansion, we've invested in continuous improvements in operations and technology, including advances in reducing energy intensity and the impact of our operations on the air, land and water. Suncor continues to strive for a model of sustainable development, investing in research and development and new technology that not only improves financial performance but our social and environmental performance as well. In addition, our Oil Sands operations and the Suncor Energy Foundation are proud to have made numerous community investments in the Fort McMurray - Wood Buffalo region.

As outlined in the table on the next page, Suncor has and continues to contribute a number of benefits to Albertans, including jobs, royalties and taxes paid to various levels of government. This growth has not been without challenges but industry, governments and communities are collaborating and working aggressively to address them.

Year	Oil Sands Capital Investment	Oil Sands Employees	Suncor-wide royalty & tax payments to all levels of gov't
1996	\$321 million	1,430	\$477 million
2006	\$2.4 billion	3,180	\$1.7 billion
2015 (projected)	\$1.6 billion	7,800	\$3.7 billion*

*assumes \$60US W.T.I. with a market-based bitumen royalty, and achievement of growth plans to 2012, with 550,000bpd maintained through 2015. Approximately \$1.5 billion would be royalties.¹

In response to the Royalty Review panel, Suncor has organized its submission in a similar fashion to the terms of reference the panel was asked to consider, under the following headings:

- *How Alberta's royalty system and tax treatment compares to other oil and gas producing jurisdictions, taking into account investment economics and industry returns and risks in Alberta.*
- *Whether Alberta's royalty system is sufficiently sensitive to market conditions.*
- *Whether the current revenue minus cost system for oil sands royalties is optimal.*
- *Which programs built into the existing royalty system should be retained or strengthened, and which should be adapted or eliminated.*
- *The economic and fiscal impacts of any possible changes to the royalty and corporate tax systems.*
- *How existing resource development should be treated if changes are made to the fiscal regime.*

How Alberta's royalty system and tax treatment compares to other oil and gas producing jurisdictions, taking into account investment economics and industry returns and risks in Alberta.

In comparing the tax treatment of the Alberta oil sands, it should be noted that multiple jurisdictions around the world provide fiscal regimes where risk is shared between government and private industry in the development of multi-billion dollar mega-projects. In fact, among these global mega-projects, oil sands developments are considered among the most marginal investments. Suncor believes that given the long-term economic and social benefits received by the Alberta government from these projects, it is appropriate to have some sharing of risk between the private sector and government.

The royalty system by itself is only one factor in the international comparison of the economic returns to investors for oil and gas development. When considering government's share of this development, taxes and royalties must be considered together. Analysis by the Canadian Association of Petroleum Producer's has shown that Canada's regime, prior to the federal elimination of ACCA, was internationally competitive with a 49:51 sharing of marginal net revenues between government and industry. This is slightly higher than the government take for offshore developments in the Gulf of Mexico, equal to Alaska's

¹ Royalties and taxes are highly sensitive to other factors as well, including foreign exchange rates and capital and other operating costs. Accordingly, in light of these uncertainties, actual differences may be material.

proposed take under the 'economic limit factor' and slightly lower than the Australian government's take².

World scale oil sands mega projects are unique, making it more difficult to draw direct comparisons to other jurisdictions. Similar resources exist in countries with lower operating costs, lower environmental standards, and higher supplies of labour. However, these factors are also offset by associated political risks. Historically, Alberta has had a relatively stable fiscal regime for the development of the oil sands. However, the challenging weather conditions experienced in the areas where oil sands deposits are found create operational issues and production interruptions that are certainly comparable to, or arguably worse than, the conditions found in other large-scale developments such as offshore. In addition, Alberta has some of the highest labor and capital costs in the world. In January of this year, CIBC World Markets estimated that an oil sands operation needed to receive \$50 US per barrel of synthetic crude oil, in order to provide investors with an 11% rate of return.³ To further this argument, in its analyst report released in January 2007, Goldman Sachs indicated that new oil sands projects in Alberta would provide a marginal investment return, compared to other potential new mega projects for resource development worldwide.⁴

Prior to cancellation of the Federal ACCA, federal tax policy worked together with the provincial royalty regime to appropriately share risk, while encouraging oil sands development. This made the oil sands fiscal regime comparable to other international tax arrangements for high-risk, mega-project developments. The extension of ACCA provisions from mining projects to oil sands mining projects in 1974 helped level the playing field between oil sands and other types of mining developments. In 1996, ACCA provisions were extended to in-situ operations as a result of the NOSTF, further enabling development of the oil sands industry.

Elimination of the Federal ACCA for oil sands places these developments at a distinct disadvantage, as compared to other Canadian mining developments and affects comparisons between mining operations. Removal of the Federal ACCA also has the negative effect of delaying the amount of time it takes to pay-out project investments. This has two effects on oil sands businesses: 1) it reduces available cash flow resulting in lower returns, and 2) it exposes investors to a longer period of time before pay-out, resulting in an increase in returns required before capital investment can occur. The positive effect for governments from the cancellation of ACCA is that they acquire tax revenue sooner. However, earlier tax revenue may come at the expense of less development and innovation by oil sands companies in the long term.

It is also important that the full effects of the cancellation of the Federal ACCA are understood in reviewing the need for the provincial ACCA for oil sands. Suncor believes that the cancellation of the provincial ACCA would further exacerbate the inequities already created by the cancellation of the federal ACCA. We also believe that the government would be discouraging a key component of its long-term vision for the province, namely encouraging a long-term upgrading base in oil sands beyond current plans, that would provide a predictable source of tax revenue in the future. Since the ACCA encourages this type of development, it would not be in the province's best interest to remove this treatment for oil sands.

² Canadian Association of Petroleum Producers. *Oil Sands: Benefits to Alberta and Canada, today and tomorrow, through a fair, stable and competitive fiscal regime*. Pg 31, 35. May, 2007.

³ CIBC World Markets. *Canada's Oil Sands – A Valuable Resource But Entry Costs are High*. Jan 22, 2007.

⁴ Goldman Sachs. *170 Projects to Change the World*. February 20, 2007.

Whether Alberta's royalty system is sufficiently sensitive to market conditions.

History has demonstrated that the fiscal regime works in high commodity price cycles as well as low ones. To evidence this, the Alberta government will receive \$2.4 billion this year in royalties from oil sands developers, as 33 of 65 projects have achieved payout so far. This compares to \$250 million in oil sands royalties collected by government only three years ago. The regime also protects oil sands development during low commodity price cycles, by facilitating the payout of capital before the 25% royalty is payable. Developers are forced to use substantially lower prices in their business cases for making investment decisions, so the rate of capital payout has a major impact on project economics. Without protection during low commodity price cycles, most projects would not proceed. For instance, during the process of making the decision to proceed with Suncor's project Millennium in 1999, WTI prices hit \$12/bbl. Despite this fact the Millennium project continued, successfully reaching its final stages of completion. It is worth noting that by the time project Millennium had reached its final stages, oil prices had recovered, leading to a rapid pay out of the project for royalty purposes.

The Alberta government's system of competitive mineral lease bids provides another way to adjust for significant price swings associated with the collection of royalties from oil sands. As royalty rates increase, bids for mineral leases decrease and vice versa. Bidding is conducted in an open and transparent manner by government. According to the Canadian Association of Petroleum Producers, in 2006-07 oil sands lease revenues generated a total of \$1.3 billion for the Alberta government.⁵

Going forward, Suncor believes that the Alberta government's revenue from oil sands royalties will remain strong. This is based on Suncor's projected royalties and taxes, and takes into consideration the total revenue payable by industry by 2015, once current major projects have been completed. The economic multipliers from these projects will also contribute substantially to economic development within the province, and in turn contribute to the revenues of the Alberta government. The regime is internationally competitive and it is working as intended, by allowing Albertans to share sooner in the wealth generated by oil sands development when prices are high, while protecting the developer when prices are low.

⁵ Canadian Association of Petroleum Producers. *Oil Sands: Benefits to Alberta and Canada, today and tomorrow, through a fair, stable and competitive fiscal regime.* Pg 21. May, 2007.

Whether the current revenue minus cost system for oil sands royalties is optimal.

The existing revenue minus costs system continues to be optimal because it recognizes the differences in risk profiles between high cost, long-lead time oil sands developments and conventional oil and gas production.

In order to develop the oil sands, industry fronts 100% of the massive capital investment needed to construct the projects. During project development and commissioning (lasting 5 to 7 years), industry is exposed to major risks, due to the volatility of prices for construction materials, as well as the availability of skilled labour. Once up and running these projects have a long production life of 40 plus years. However, oil sands operators still face reliability issues due to such factors as production interruptions, extreme weather conditions and rapid equipment deterioration and failure. Due to these facts, the most meaningful fiscal regime components for oil sands allow a reduction of capital at risk as soon as possible. This is why the revenue minus cost approach for both royalties and tax (prior to elimination of ACCA) was critical to attracting capital investment.

Conversely in conventional oil and gas production, risks are inherent in exploration and finding costs. Time lags from exploration to production are measured in days or months, rather than years. As a result, if adverse economic conditions occur, capital budgets can be stopped or deferred. In addition, conventional wells only have an average life span of 7 years, meaning that continuous drilling is required in order to maintain production levels. Accordingly, the most meaningful fiscal regime components for conventional oil and gas development provide tax write-offs of exploration costs immediately and development costs over a 30% declining balance basis. Tangible costs are not added to conventional wells until successful, so the equipment write-off is based on useful life. The conventional royalty for economic rent is based on gross revenue for crude oil and natural gas due to the short life and short payout of capital invested on successful wells.

The generic regime on a net cost basis, aligns the economic drivers of the resource owner and the developer, since it promotes behavior that maximizes the return to both parties through net revenue sharing. Developers have incentive to do whatever is possible to reduce capital and operating costs and optimize revenue for investment purposes. These incentives also benefit royalty and tax authorities through enhanced revenues. The regime protects the investor by facilitating payout of the capital invested before royalty and tax-sharing applies. After payout, then government and industry are on the same footing, sharing in the risks and benefits.

Which programs built into the existing royalty system should be retained or strengthened, and which should be adapted or eliminated.

The oil sands fiscal regime has been built on a solid foundation of past precedent and policy. The regime includes many features that were part of Suncor's original agreements with the Alberta government, dating back to the 1960's, plus careful analysis and consideration during the time of the National Oil Sands Task Force in the mid-90's. While we believe the regime remains appropriate, fair and competitive, there may be opportunities for simplification, certainty, clarification and reduction of administration, providing they are made under the principles of revenue neutrality. These changes could benefit government, industry and taxpayers.

As an example, oil sands project definition terms could be clarified, including the simplification of allowed overhead costs. Industry and Alberta Energy currently approach administrative issues such as this, through the Oil Sands Royalty Steering Committee. This group could be provided a mandate and terms of reference to assess options in these areas, which may result in greater efficiency in the use of people and resources by both industry and government in administering the current regime.

For maximum effectiveness, the provincial royalty regime should be integrated and consistent with public policy formulated within government departments other than Alberta Energy. For example, the royalty regulations ought to provide that bitumen production division costs for environmental management (such as reclamation or greenhouse gas reduction obligations), employee health and land use are allowed costs for royalty purposes.

Suncor would support a recommendation to provide the Oil Sands Steering Committee with a specific mandate, principles and time frame on which to prepare recommendations to the Minister in respect of these details. This includes advancing improvements, while ensuring they are appropriately considered in terms of all ramifications to oil sands projects.

The economic and fiscal impacts of any possible changes to the royalty and corporate tax systems.

In determining the impacts of changes to the royalty and corporate tax system, factors that contribute to the risks and returns associated with oil sands developments should be reflected upon. Such factors include the availability of skilled labour, evolving environmental policy and the remote location of oil sands deposits. Changes in royalty and corporate tax systems, combined with these factors, could affect future business decisions regarding the jurisdictions in which major developments are built. It should be noted that the Alberta government's ACCA for oil sands provides incentive for upgrading in the province. Despite the fact that costs may be lower to develop upgraders in other jurisdictions, Alberta's policy of extending the ACCA to oil sands helps to keep these projects within the province.

It is also important to consider international developments, such as changes in Venezuelan heavy oil production. We still do not have a full understanding of how these changes will impact Alberta and North American markets. The governments of Canada and Alberta should be positioning the industry for competitiveness with other international developments, as opposed to changing the fiscal regime, which will lessen our competitiveness.

How existing resource development should be treated if changes are made to the fiscal regime.

If changes are made to the oil sands fiscal regime, it would be inappropriate to apply new royalty and taxation rules to projects that are either already approved, under construction or in the pre pay-out phase. Significant investments have already been committed to oil sands development and these investments must be paid out before any changes in the regime can take effect. Any immediate changes to the fiscal regime should apply only to projects in the post pay-out phase, and future projects so that these factors can be properly considered as part of any forthcoming investment decisions.

To limit investor uncertainty, it would also be prudent to complete the royalty review as soon as possible. This includes undertaking appropriate consultation with industry regarding the implementation of any changes proposed by government.

Conclusion

It is important to stress the fact that the generic oil sands regime, combined with technological advances and higher crude prices, significantly aided the advancement of Alberta's oil sands industry in the last 10 years. These factors have enabled investment in further technological improvements to lower operating costs and reduce our environmental footprint. At the same time, the success of the oil sands industry has allowed developers to invest in the communities where we operate. Any changes to the generic regime may limit the amount of investment dollars available to address future environmental and social challenges.

To re-state the main areas of focus in our submission, Suncor would like to make the following suggestions to the panel:

- The generic oil sands royalty regime continues to strike the right balance between encouraging the development of Alberta's oil sands and ensuring Albertans' fair share of resource royalties. Oil sands developments involve long lead-times for construction and large risks for investors. Consequently, significant changes are not needed to the regime at this time.
- In calculating total government share of oil sands revenues, it is important to take into account income tax and federal government share in addition to royalties. The effects of the recent Federal cancellation of ACCA for oil sands should also be kept in mind when determining any changes to the regime.
- The unique nature of oil sands developments must be taken into account, including the many challenges associated with production. Comparisons with similar international oil projects show that Canada's oil sands have some of the highest costs and most stringent environmental standards in the world.
- Improvements to the generic oil sands royalty regime could include a better definition of project terms and ensuring that royalty policies do not conflict with other government policy. Any changes to the regime must be made using the principle of revenue neutrality. Suncor also supports the involvement of the Oil Sands Steering Committee to implement these changes.
- Immediate changes in the oil sands fiscal regime should apply to future projects, so that these factors can be properly considered as part of any forthcoming investment decisions. To limit investor uncertainty, the royalty review should be completed as soon as possible.

Suncor thanks the royalty review panel and the Alberta government for the opportunity to put our ideas forward for consideration. We would be happy to offer further policy expertise to the panel on these subject matters, and look forward to continuing to work with the government on these issues in the future.

Appendix – A Historic Perspective on Oil Sands development

Suncor can speak to the success of the generic oil sands royalty regime from the perspective of our own corporate history. Prior to 1995, Suncor averaged 58,000 bpd of production. These operations were plagued with reliability issues due to such factors as production interruptions, extreme weather conditions and rapid equipment deterioration and failure. Suncor's operations featured only one continuous production train, meaning that if one component of the operations went down, the entire operation went down, resulting in frequent production disruptions. Even today, many oil sands developments still struggle with these type of reliability issues.

During this time, Suncor paid royalties on synthetic crude oil production using a similar two-tier royalty system: 5% on gross revenue before capital was paid off; and 30% on net revenue, with allowance for overhead costs, once the project was paid in full. Tax provisions during this time only extended ACCA in full for income from the project; and an extension of resource allowance resulted in a notional deduction in excess of crown royalties. A number of other special incentives for oil sands, such as 'super depletion', investment tax credits and earned depletion, were eliminated in the late 1980's. Simple pay-out of Suncor's base mine operations did not occur until 25 years of operation, in 1992.

In the mid-1990's Suncor averaged 70,000 barrels per day of synthetic crude oil production. Technological advancements had improved energy intensity and physical reliability, driving down operating costs. However high royalties, combined with volatile oil prices, meant that oil sands producers still did not have the cash flow to proceed with further capital projects. As an example Suncor's parent company, the U.S.-based Sun Oil, would not make further investments in oil sands capital. Sun Oil sold all remaining interests in Suncor in 1995.

In 1996, the National Oil Sands Task Force (NOSTF) made proposals for changes to the provincial and federal oil sands fiscal regime. The goal of the NOSTF was to reduce royalty and income tax rates, while at the same time broadening the royalty and tax base from the resulting additional oil sands development which would occur.

In 1997, the Alberta and Federal government worked with industry to create a solid fiscal foundation on which to commercially develop Alberta's oil sands resource. For the provincial government, the generic royalty regime created a bitumen-based royalty. The federal government also extended oil sands mining ACCA to in-situ projects to encourage commercial development.

Suncor expanded its operations in 1998, shortly after the NOSTF, to 105,000 bpd. As part of our Millennium expansion in 2001, production more than doubled, including additional extraction and upgrading operations. In 2005 Suncor announced its Voyageur Project to expand production to a half million bpd by 2012, through additional mining, in-situ operations and a third upgrader. In 2005, a further upgrading expansion increased our synthetic crude oil production to 260,000 bpd.

Despite upward costs pressures, due to such factors as labour and material shortages, Suncor continues to strive for a model of sustainable development, making major investments in research and development, and improvements to our operations that benefit not just our financial bottom line, but the environment and social well-being of the communities within which we operate.