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Re: Suncor Energy Inc. Follow-up to written submission and presentation

Further to your request for additional information and our offer to respond to the panel, Suncor has provided the following.

Manufacturing & Processing (“M&P”) equipment fast write off from the 2007 Federal budget – applicability to oil sands upgrading costs

This Federal budget provision, to permit M&P capital incurred before 2009 to qualify for a 2 year write off, is not relevant to the elimination of ACCA for oil sands. The capital cost allowance (CCA) rate for upgrading equipment is 25% in Class 41. The ACCA rules allow for an incremental deduction of up to 100% of the balance remaining in the CCA pool for a separate mine (or mines), subject to a limitation of income from the mine(s). The ACCA will be eliminated after Jan 1, 2011, subject to certain grandfathering rules for projects which started construction prior to Mar 19, 2007, and will be phased out by 2015

Accordingly, oil sands developers would not claim M&P CCA for upgrading in the interim since it would take until 2015 before the total CCA rate would reach 25%. It should be noted that the ACCA tax write off for oil sands was faster than the US write off rate (a 50% bonus depreciation and certain other measures). This used to offset the higher cost of construction in Alberta, as compared to building in other jurisdictions.

Oil Sands Investment Economics

For investment economics, oil sands developers consider price expectations over the full life of their projects rather than ‘point-in-time’ estimates. Market prices at the time of decisions are less relevant than expectations for prices over the life of the investment. Due to project magnitudes and long lead times, current market high or low prices for crude oil or bitumen are not a factor. As indicated during our presentation, Suncor made the final decision to proceed with Project Millennium in 1998, when the price of oil was at \$12WTI. However, Suncor had hedged a significant portion of our future cash flow at mid-cycle prices to ensure we had the cash flow to fund the investment.

Conversely, costs do not generally decrease when crude prices decline – labor costs can rarely be decreased, except from attrition. Other embedded costs that oil sands developers face in times of high crude prices almost never get reduced substantially once crude prices have dropped, or only after a major lag time. Historically, the industry has successfully overcome this cost effect through major technology step changes, and this process is continuous.

High Labour and Capital Costs

In response to Suncor's written submission and presentation, questions also arose from the panel regarding statements of high labour and capital costs for oil sands operators. To further evidence these claims, Suncor would like to draw to the panel's attention a recent Vancouver Sun article, which has shown that oil sands capital costs have risen by 55% since early 2005, mostly due to increases in costs for labour and construction materials, and other related overhead expenses¹. It should be noted that labour and raw materials costs account for roughly two-thirds of total budgets for major oil sands projects.

According to the same article, a representative of the Canadian Energy Research Institute stated that the cost of steel, a major component in oil sands project construction, has gone up 70% since 2002. The cost of labour has risen 20% in the same period.² This Vancouver Sun article was based on an industry report recently released by Wood Mackenzie. We are aware that the panel now has access to several of these industry reports.

Suncor would also encourage the panel to examine the most recent actual oil sands operating costs per bbl realized by Suncor, and other public companies with primary oil sands operations³. It should be noted that these operating cash costs and earnings do not reflect sustaining capital costs, which are substantial and are not discretionary.

Government Take

Suncor's submission and presentation highlighted that government's combined take from Alberta's oil sands was slightly higher than the government take for offshore developments in the Gulf of Mexico, approximately equal to the take under Alaska's proposed 'economic limit factor' and slightly lower than the Australian government's take. This was based on March 30, 2006 testimony to the Alaskan House Finance Committee by CRA International⁴. In making this comparison, Suncor notes slide 12, which charts the total government take versus the total technical cost for recovery of resources, in a comparable group of mature OECD producing countries. We would further note slide 16 of this presentation, which charts total government take in these same jurisdictions over varying oil prices, and slide 17, which captures total government take versus changing technical costs of development. These slides show that as compared to the regressive royalty and taxation schemes common in comparable

¹ Dutta, Ashok. "Oil extraction costs rise 55 per cent". Vancouver Sun. March 7, 2007. Available at: <http://www.canada.com/vancouversun/story.html?id=7678a851-5159-437b-bf76-a3bed9e2cca9&k=17011>
Accessed June 21, 2007.

² Ibid.

³ Suncor Energy Inc. 'Suncor Energy reports strong financial performance Oil sands growth plans on schedule and on budget'. *Report to shareholders for the period ended March 31, 2007*. Pg 3. Available at: http://www.suncor.com/data/1/rec_docs/1335_Q1%202007%20final.pdf
Accessed June 21, 2007

⁴ Bramely, David. CRA International. *Review of Alaskan Fiscal Proposals*. Presentation to the Alaskan House Finance Committee. March 30, 2006. Available at: http://www.akrepublicans.org/houres/24/pdfs/houres_hb488_48.pdf Accessed June 21, 2007.

jurisdictions, the government take in Alberta's oil sands remain constant for varying oil prices and costs of development.

Bitumen Royalty

Suncor had been working with the government since 1992 to transition to a bitumen-based royalty. This was due to the fact that the synthetic crude oil-based royalty was not economic to permit expansion of Suncor's operations, and markets for bitumen were developing. The bitumen-based royalty was an integral part of the National Oil Sands Task Force in 1994-1996, leading up to the introduction of the Alberta Generic Regime. It remains Suncor's position that economic rent for a natural resource should be on the first marketable product. As pointed out in our presentation to the panel, bitumen markets are now more efficient, transparent and arms length. In the table Suncor provided in its earlier submission, it shows that there has been an increase of 250% both in our company's production and the royalties and taxes paid to government from 1996 to 2006, and we expect these figures to again double by 2015. Suncor's development to date has relied on the economics of a market-based bitumen royalty, which involved investing approximately 100% of our cash flow through this time frame. A significant portion of our royalties are already bitumen-based for sales of bitumen and production processed through upgraders that are not part of the royalty project. As highlighted in Suncor's presentation to the panel, bitumen markets are now more efficient, transparent and arms length.

Price Sensitive or Super Return Royalties

During the course of the royalty review sessions, several presenters were asked to comment on a proposed 'price sensitive royalty' and other similar options. It is Suncor's view that a sliding scale royalty based on commodity prices would be regressive, and create major issues for industry. Margins are still very tight in oil sands production and reinvestment of cash flow remains at levels close to 100%.

Oil sands developers' access to capital is instrumental in achieving technological advancements, cost reductions and lessening environmental footprints from development. Historic step changes in technology have cost hundreds of millions of dollars. In addition, developers often hedge their upside, to protect against a downturn in prices, particularly when projects are under construction. The royalty regime does not recognize these losses when developers earn higher prices. This would, in effect, make a price sensitive royalty a hardship.

Any super return royalty would be extremely complex to apply in an oil sands context, which is very different from single wells. This would include major issues with respect to an appropriate risk adjusted return for such levels. The foregoing comments with respect to hedging would also be a concern. In addition the treatment of reclamation, other environmental activities, costs and taxes for the project's full life cycle would need to be considered. It would be regressive, inappropriate and inconsistent with public policy to collect a royalty in mid-cycle during a higher margin period, without providing for cash refunds when returns are reduced, due to interruptions in production or during final reclamation. It is Suncor's view that if most oil sands projects were examined on a full life-cycle basis, that none have or will achieve a "super" return. Given this conclusion, the administration, market uncertainty and inability to estimate and measure such a

regime effectively by either government or industry would create more cost than benefit to the people of Alberta.

Overall, Suncor submits that the royalty regime is working as it was intended and we would urge the panel not to increase royalties now, particularly when the industry is experiencing its first major growth period since commercial development began over 30 years ago. If you require further information, please contact us.