

Canadian Oil Sands Trust

Marcel Coutu

ROYALTY REVIEW PRESENTATION

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SLIDE 1

Good afternoon. I appreciate the opportunity to present to the oil sands royalty review panel today. My name is Marcel Coutu and I am the President and Chief Executive Officer of Canadian Oil Sands Limited, manager of Canadian Oil Sands Trust. I am also the Chairman of Syncrude Canada Ltd. and represent a group of seven corporate owners.

I will focus my comments specifically on our Syncrude project to illustrate how Alberta's fiscal regime has worked to support our development, why it should be retained in its current form and the success of the regime in delivering fair returns to both the owners of the resource, Albertans, and those risking capital to develop it.

SLIDE 2

By way of introduction, Canadian Oil Sands Trust owns the largest interest in the Syncrude joint venture and provides public investors with the only pure, direct investment opportunity in the project, affording us a unique perspective.

As the largest Canadian income trust, we provide a very transparent distribution to our investors that would be directly impacted by any royalty change. In this regard, we are already facing a significant reduction in the amount available for distribution as a result of the federal government's plan to begin taxing income trusts in 2011.

This panel has already heard many of the main points covered by my peers – that oil sands remain a challenging business, capital and operating costs are escalating at a higher rate than oil prices and a stable, fair regime is required to retain and attract investment to

develop the oil sands. I intend to illustrate those points in concrete terms through our Syncrude project.

Syncrude is one of the pioneers in the oil sands business with close to 30 years of operating experience. They have moved from basically an R&D effort to explore the potential of the oil sands, to a successful commercial venture providing significant benefits to the local communities, including the Aboriginal people, Albertans and the rest of Canada. Throughout its history, Syncrude has been recognized as a leader in technological innovation and responsible development. Finally, Syncrude has just completed a major expansion so our experience is particularly relevant.

SLIDE 3

Syncrude's Stage 3 is the most recent expansion to be completed in the oil sands, coming onstream in the second half of last year. It was the largest expansion in Syncrude's history and, despite Syncrude's experience in successfully completing large capital projects, Stage 3 proved particularly challenging and illustrates the risks assumed when embarking on such projects.

Syncrude's owners approved the expansion in December 2001 based on a capital cost of \$4.1 billion. With oil prices at the time just under \$20 per barrel, the current royalty regime was a key factor in supporting the owners' decision to proceed with the project. The expected stability of this fiscal regime helped offset the significant risks inherent in a multi-billion dollar, multi-year project that wasn't to provide any cash flow for many years.

Stage 3 incurred both delays in completion and cost overruns. It was particularly difficult for Canadian Oil Sands because we had to ensure we had the funds to finance our share of the increased costs. Our unit price declined about 20% when we announced the biggest jump in expected costs – a \$2 billion increase, which made it unattractive to access the equity markets. And we had already leveraged up our balance sheet with debt;

fortunately, though, robust crude oil prices ultimately supported our ability to finance the project. The royalty regime did provide some shelter for the cost overrun but nonetheless we still ended up paying 75 cents on every dollar of that cost overrun.

The significant appreciation in crude oil prices, which rose 276% during the course of the Stage 3 construction, helped preserve the economics of the project. Indeed, it is likely that the owners, in the absence of crude oil price foresight, would not have proceeded with the expansion had they known the original estimated cost would double.

Projects proposed today or being constructed are facing even greater challenges. We actually constructed Stage 3 during a relative lull in the sector and before the escalation in steel and concrete prices. Even then, we had difficulty sourcing the engineering and project management capacity, leading to delays in construction and ultimately increasing the costs. This was a result of strong global demand for these services and not just a reflection of regional pressures. Growth in areas such as China and India are pushing up demand, and consequently costs, for engineering, procurement and construction services.

While operating projects today are facing higher cost pressures, many are also greenfield projects, meaning they do not have an existing operating base and expertise to support their development like Syncrude did.

In light of such pressures, a stable, competitive fiscal regime is even more imperative to enable us and others to grow Alberta's oil sands resource – a significant driver in Canada's economy today.

The decision to proceed with an oil sands project carries much risk – huge investments with the potential for dramatic cost increases, uncertainty about the direction of commodity prices, and technical challenges with the only certainty being that it will be several years out before you get even a single drop of oil from the facility.

The benefit is that once these projects are constructed, you have the infrastructure in place to produce substantial volumes of crude oil for decades. In that regard, an oil sands operation is very much like a manufacturing operation – and the key is to get the facility installed, and installed here in Alberta. Later in my presentation, I will describe how Syncrude benefits the province and the country.

SLIDE 4

Cost pressures are not only evident on the capital construction side. As you can see from Syncrude's operating history, they are also impacting operating costs. In fact, Syncrude's operating costs have almost doubled from what they were in 1996 when the current royalty regime was introduced.

Much of this increase is due to the rise in natural gas prices, which tracked the rise in crude oil prices. We use natural gas primarily as a hydrogen source to upgrade our crude oil into a premium, light, sweet blend.

The rise in crude oil prices also leads to inflation in other input costs – from labour to materials. And as I mentioned, an oil sands plant is like a manufacturing operation. Most of the costs are fixed, which means an increase in production volumes can lead to lower per barrel operating costs. However, it also means that the cost structure is inflexible to a decline in crude oil prices – there is limited opportunity to cut costs in a lower oil price environment. It takes a long time for lower crude oil prices to work their way into a decline in our cost inputs, squeezing margins in the interim. Furthermore, you cannot just shut down an oil sands operation. Even during low price cycles, operations must be maintained to ensure integrity of the plant and preservation of a skilled workforce.

In addition to operating costs, we incur sustaining capital to maintain our existing operation. Syncrude's sustaining capital has increased dramatically from \$1.50 per barrel to about \$5 per barrel over the last 10 years.

Thus, focusing only on the appreciation in crude oil prices fails to acknowledge the increase in costs – both capital and operating. In addition to cost inflation, the industry is facing new costs for compliance with emissions regulations. These are further reasons why we need a stable, competitive fiscal regime to support oil sands economics.

SLIDE 5

The current royalty regime supported development of our Stage 3 project by providing certainty around the fiscal terms and allowing for a deferral of higher royalty payments until we recovered project costs. Essentially, both Syncrude and the government invested in a project that would provide greater returns for decades into the future.

The regime accomplished what it was designed to. Syncrude continued to pay a royalty throughout the Stage 3 construction period, and in mid 2006, we moved to the higher royalty rate of 25% of net revenues. Syncrude is now paying more than ever in royalties from an expanded revenue base. Furthermore, given the size of Syncrude's operating base, it is unlikely we will ever fully revert to the lower royalty rate again, even as we execute our future growth stages.

In 2007, Crown royalties from Syncrude are expected to approach \$1 billion, or just over \$8 per barrel. The amount of royalties reflect oil prices – enabling Albertans to share in the upside of crude oil prices.

Syncrude's transition to the higher royalty rate is a recent event being experienced throughout the sector. In fact, over 74% of oil sands production under the current regime is now paying the 25% post-payout royalty.

SLIDE 6

We must also consider benefits other than just royalties to determine the return to Albertans. There is tremendous value in developing this resource, as evidenced by

Syncrude's economic contribution. Since startup in 1978, Syncrude has paid a cumulative total of more than \$7.5 billion to governments for royalties, payroll taxes, municipal taxes and other Crown charges. Our operation employs more than 4,500 people. We have made significant capital investments to upgrade bitumen to produce a light, sweet synthetic. In fact, in expansions alone over the past 10 years, Syncrude has invested about \$10 billion. This means that all of the value-added upgrading and associated benefits remain within the province for decades. In addition to capital investments, Syncrude spends about \$40 million annually on research and development, making us one of the top R&D spenders in the country.

It's critical to note that this graph depicts Syncrude's contribution prior to full operations from our Stage 3 expansion. We expect royalties to grow as we ramp up production, with payments doubling in less than 5 years. And royalties are only one part of the full benefits picture.

While Syncrude makes a significant economic contribution, we are also a responsible developer of our oil sands resource, demonstrating a strong record of water management, land reclamation and emissions reductions.

The main point I am continuing to drive home is that oil sands projects can be managed responsibly, and that once constructed, they provide long-term economic growth, job creation and revenue to support the quality of life we all enjoy.

SLIDE 7

What you are really risking by considering an increase in the royalty rate is future development in the sector. This slide is simply to illustrate that point. Raising the royalty rate may mean you just get a larger slice of a smaller pie, leaving us no further ahead. In our opinion, the value to Albertans is maximized by growing the industry, not by changing the royalty regime and stemming future growth.

SLIDE 8

Oil sands projects have a unique set of challenges and risks, the main ones being outlined on this slide. The reward is the size of the resource and the potential for continued increases in crude oil prices. This risk/reward balance is now being threatened – costs are increasing faster than oil prices, new costs are emerging in the form of greenhouse gas emissions legislation; tax policy is changing with the withdrawal of the ACCA; and in our case, the very onerous application of a new 31.5% tax for income trusts. The result is that the investment community and operators are becoming increasingly cautious towards the sector. Capital is very mobile and will move to where the best risk/reward balance seems to be – and is not limited to oil and gas investment opportunities. More than ever, we need a stable, fair and competitive royalty regime to provide some certainty in an increasingly unstable environment.

A change in the royalty also could suggest more changes in the future, reducing confidence and thereby affecting not only the cash flows of a project, but also the risk profile. To compensate for the higher risk being assumed, investors would expect a higher rate of return. The spiraling result is that it will be increasingly difficult to attract capital to the sector. There is untold value in maintaining Alberta's reputation as providing a stable fiscal regime.

In conclusion, I hope by sharing Syncrude's experience I have helped to illustrate the challenges of oil sands development and the benefits these projects ultimately provide.

I believe there is value in conducting a review of the royalty. We all appreciate we have a tremendous resource in Canada's oil sands and share the goal of ensuring its development is optimized and managed responsibly.

The current royalty regime recognizes that, while the potential of the oil sands is enormous, it is a particularly challenging resource to develop. The regime evolved after careful consideration of the unique risks, establishing a single set of industry rules to

reduce risk and encourage investment. The regime recognizes these are long-life projects and the royalty needs to be based on the entire project life to capture the full value. Once these projects are constructed, they generate significant economic benefit for decades.

We are just beginning to realize the potential of the oil sands. This is not an established, mature business. Significant technology risks remain, simply to extract the resource economically in a rising cost environment. The combination of Alberta's stable fiscal regime and strong crude oil prices has encouraged investors to risk their capital in this frontier resource. But the environment is changing. Higher costs, the continuing rise in the Canadian dollar, and growing risks and uncertainty are eroding economics. This alone will likely lead to reduced activity.

It has been only the last few years that we saw a number of positive drivers converge to propel Canada on the world scene for crude oil resource. We are just now beginning to capitalize on the positive momentum that took years to create. A delicate balance is in place that I believe will be upset if a change to the royalty regime is introduced. Accordingly, I highly recommend against a change in the current royalty regime.

That concludes my formal remarks. The appendix to this presentation includes further information for your consideration.

Thank you, and I would be happy to take any questions you may have.