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Legislation to implement New Royalty Framework introduced

New rates take effect January 2009 production month

Edmonton... Alberta's *New Royalty Framework*, announced by Premier Ed Stelmach last fall will gain legislative authority under a new Act introduced in the Alberta Legislature.

The *Mines and Minerals (New Royalty Framework) Amendment Act, 2008* will enable the implementation of regulations for a sliding scale of new, price sensitive royalties. The royalty scales take into account fluctuating commodity prices by providing increased returns for Albertans when prices are high, while offering lower royalty rates when prices are low to promote continued investment and development. The Act will also give the province the tools to pursue new opportunities for value-added development by collecting bitumen or other products from oil sands operators in lieu of cash royalties and to encourage new investment in shallow resource pools.

The Act will also give Cabinet the authority to pass regulations to strengthen the accountability systems necessary to ensure complete and timely reporting on royalties owed to the province. This responds to recommendations made by the Auditor General and by Peter Valentine in his report, *Building Confidence: Improving Accountability and Transparency in Alberta's Royalty System*.

"The recent volatility of commodity prices shows how the new sliding royalty rates for our non-renewable resources are well suited to the changing times," said Energy Minister Mel Knight. "The *New Royalty Framework* will increase resource revenues to the province when prices are high, while maintaining Alberta's competitive advantage when commodity prices are low."

The new framework takes effect with the January 2009 production month. It represents the most significant change to Alberta's royalty structure since 1997, when the generic oil sands regime and changes to the federal capital cost allowance encouraged new development when prices were much lower (\$22 per barrel).

"Much like the way we used our royalty structure to respond to a changing environment in the late 1990s, the new framework will give Alberta new tools to create opportunities for investment and job creation," added Knight. The new tools include shallow rights reversion to encourage development of shallow resource pools previously frozen out by deeper production and bitumen royalty in-kind, which will help to create a strategic feedstock supply for Alberta-based value-added industries.

Implementation of the *New Royalty Framework* requires amendments to the *Mines and Minerals Act*, and the enactment of seven regulations. Alberta Energy has also been required to make significant changes to a number of specialized information technology applications to reflect the new royalty structures.

Media inquiries may be directed to:

Bob McManus

Assistant Director of Communications

Alberta Energy

Phone: 780-422-0068 / Cell: 780-965-0352

To call toll free within Alberta dial 310-0000.

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Additional information on the Mines and Minerals (New Royalty Framework) Amendment Act, 2008

Why is a new Act required?

The *Mines and Minerals Amendment Act* specifies how and when the Crown may take bitumen in lieu of cash royalties, allowing the province to encourage more value added development. It gives the Crown the tools to encourage greater development of existing shallow resource pools, and authority to set oil sands royalty rates and strengthen industry accountability. Currently, royalties for conventional oil and natural gas are set by regulation. The generic oil sands regime is set in legislation and amendments in this Act will empower cabinet to also set rates for oil, natural gas and oil sands production via regulation.

Does the new Act over-ride the Crown Agreements with Syncrude and Suncor?

No. The provincial government indicated when it announced the *New Royalty Framework* that it did not plan to unilaterally change those contracts. Since then an agreement has been reached with Suncor to amend its Crown Agreement, which will see the company pay increased royalties starting in 2010—a full six years before its existing Crown agreement was scheduled to expire. Negotiations with Syncrude, which has a different Crown Agreement, are ongoing and are expected to be concluded before the end of 2008.

The Act will allow the province to accept bitumen royalty in kind. How will that work? How does it help the province to pursue new opportunities for value-added development?

The province already accepts crude oil in lieu of cash royalties on conventional and heavy oils. The oil is then sold by an agent of the Crown into the market with proceeds paid to the Provincial Treasury. The *Mines and Minerals Act* does not currently provide all the authority that may be required to implement taking bitumen royalty in kind in the simplest and most effective way. The proposed amendments allow the province to collect raw bitumen, or products from bitumen, anywhere along the value chain in lieu of cash royalties. These products could then be sold at market prices in ways that would encourage more value-added development within the province. As with conventional oil, proceeds would accrue to the Provincial Treasury.

How does Shallow Rights Reversion (SRR) encourage the development of resources located at shallow depths?

Petroleum and natural gas pools are found at varying depths. A lease or license agreement purchased from the Crown gives a company rights to produce at all levels down to the base of the deepest productive zone. Typically, the company will extract the resource from the deepest zone first, and may move to the shallower formations over time. This can often mean that zones closer to the surface may not be produced for many years.

Under SRR, the petroleum and natural gas rights above the top of the shallowest productive zone in an agreement will be severed from the agreement when it expires and the company applies to have the agreement continued. The Crown could then re-sell rights to produce those shallower zones, increasing opportunities for other firms to develop these resources and increasing royalties to the province. All mineral rights agreements purchased after January 1, 2009 will be subject to SRR. Existing agreements will be subject to SRR beginning in 2011 as companies apply to have their agreements continued.

How does the Act strengthen accountability systems?

Proper measurement of production is the starting point of accurate royalty calculation. The Act gives

cabinet authority to pass regulations that broaden the Crown's ability to set criteria for measurement and inspect facilities to ensure consistency and accuracy of volumetric data.

Volumetric data is only one measurement in calculating oil sands royalties owing. How does the department collect information to determine allowable costs in determining net revenues?

The *Mines and Minerals Amendment Act* establishes a schedule of allowed costs. The Act also requires oil sands developers to provide the department with detailed reports - some very confidential in nature - to confirm what costs the developer incurred and which are allowable.

What sort of information does the Department of Energy collect that would be considered confidential?

Any information about an operator's costs that could potentially affect its competitiveness in the industry is considered confidential. Examples of information currently collected by the department include:

- operator's forecasts, including monthly reports;
- economic data, including costs incurred for goods and services and cost to market oil sands products, prices received for oil sands products and prices charged by a project for goods and services provided to third parties - such as processing oil sands products; and
- technical reports, including technical drawings, calculations and reports of processes used to extract, recover, process, upgrade or transport oil sands products.

What regulations will need to be enacted as a result of this Act?

1. Natural Gas Royalty Regulation, 2009
2. Oil Sands Royalty Regulation, 2009
3. Petroleum Royalty Regulation, 2009
4. Deep Oil Exploratory Well Regulation
5. Natural Gas Deep Drilling Regulation
6. Oil Sands Allowed Costs (Ministerial) Regulation
7. Bitumen Valuation Methodology (Ministerial) Regulation

Timelines

Alberta has made significant changes to royalty rates on four occasions in the previous 60 years:

- **1941**-Alberta shifted the royalty rates on oil from a flat rate of 10 per cent to a choice of a 12.5 per cent flat rate or a five to 15-per-cent royalty based on production levels.
- **1972**-Royalty rates were raised at a time when the world price of oil averaged \$3 per barrel.
- **1974**-Royalties were raised again in response to higher world oil prices, which averaged \$12 per barrel.
- **1997**-the Oil Sands Generic Royalty Regime set rates and established the federal accelerated capital cost allowance for oil sands projects to encourage development. The world price of oil averaged \$22 per barrel, dropping to \$10 per barrel in 1999.
- **2007**- October 25, New Royalty Framework announced.

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