Alberta Government

Alberta's ROYALTY REVIEW 2015

ROYALTY REVIEW

During the recent election campaign, the government promised that, if elected, it would launch a review of Alberta's royalty framework. This review, announced in June, fulfills that commitment.

Many Albertans have questions about the current royalty framework. They wonder whether, as owners, Albertans are getting full and fair value from the development of our resources. Some wonder whether the province received full value in the past when prices were high. Others point out that industry costs are getting higher and higher, the oil and gas business is becoming more and more competitive, and the province needs to maintain a competitive environment to continue to attract investment. Still others suggest that we need to maintain activity in the energy industry to continue to support Alberta's economy through the current downturn in prices. Clearly, there is a wide divergence of views that need to be addressed.

In addition to those questions, it's important to recognize that the energy business is changing as a result of emerging technologies, environmental and social pressures, an evolving investment climate, and world dynamics and tensions. These forces have led to global production and market changes that have resulted in lower prices. No one knows when prices will recover or by how much, or what the energy business will look like even a generation from now.

All of this uncertainty means a royalty review at this time is critical to achieve a common base of understanding, and to assess whether the royalty framework is designed so that it will, now and in the future, meet four related objectives:

- To provide optimal returns to Albertans as owners of the resource.
- To continue to encourage industry investment.
- To encourage diversification opportunities such as value-added processing, innovation or other forms of investment in Alberta.
- And to support responsible development of the resource.

The review is intended to identify opportunities to optimize all four of these important objectives.

BACKGROUND

Alberta has the third largest reserves of oil in the world and is the largest producer of natural gas in Canada. For over a century, oil and gas development and production has contributed to the prosperity of Albertans through provincial revenues, investment, employment and infrastructure development. It can continue to be part of supporting healthy economic development, creating jobs and building stronger communities. Direct revenue to the Alberta government from the oil and gas industry comes from a number of streams including royalties, corporate taxes and land sales. Recently, new carbon levies have added a fourth direct stream. In addition, the government receives revenue from income taxes of companies and people employed by the oil and gas industry, and the economic multiplier effects of exploration, production and investment in infrastructure. The activities of oil and gas companies, and the people who work for those companies, also help fuel the economies of many communities across the province.

Oil and gas prices are the major determinant of the health of Alberta's oil and gas economy, and the main variable that determines how much revenue the provincial government gets from oil and gas activity. Prices are volatile, as Albertans know only too well. So, too, are all the economic and financial metrics associated with the oil and gas industry.

Capital investment and re-investment are vital for maintaining the economic benefits Alberta derives from the capital-intense energy industry. Such investment is sensitive to market conditions such as commodity prices, interest rates, and the relative comparability to other oil and gas producing regions. Investment is also sensitive to local costs and factors such as royalty rates, taxes and other costs the provincial government oversees. These factors plus the availability of public and private infrastructure, political and social stability, and an educated and well-trained workforce, complete the overall equation for investment.

Alberta's oil and gas industry is composed of three distinct sectors: oil sands, crude oil and liquids, and natural gas. Their relative competitive positions are not always aligned. Each is subject to different market factors that can amplify or dampen the volatility of the overall business. Each is also subject to different forces that affect the viability and competitiveness of the companies engaged in those sectors. Such forces include, but are not limited to, changes in technology, capital markets, commodity markets, global geopolitics, sustainability constraints and social pressures. As such, each must be understood and incorporated in this review.

PURPOSE

In the course of undertaking this review, the Panel will engage with Albertans, the government and industry, along with other stakeholders, to build a common set of data and facts on which to weigh issues and find common ground. That common ground will come from understanding that the "best" arrangement is not one that just maximizes government revenue, or maximizes company returns, or encourages diversification, or addresses the pace of developing the province's oil and gas resources. All four outcomes have to be optimized. With that understanding in mind, the result can be the establishment of common goals which, in turn, breed trust and innovation. Add good old hard work and we can build a robust royalty framework that optimizes all four outcomes and helps build a strong economy for Alberta's future.

The Panel also acknowledges that this review will be conducted with regard to current economic conditions as well as considering the full picture of how the energy sector benefits Albertans. The review will be sensitive to current low oil and gas prices and the associated uncertainty for investors, and to the work underway on the climate change review. That context is an important one for this review and will help frame the conversations. At the same time, the Panel will consider how the royalty framework adjusts on the upside when prices recover.

OBJECTIVE OF THE REVIEW

Working with stakeholders, the objective of the review is to establish a strong understanding of the energy sector and, based on that, to find opportunities within a royalty framework to optimize the return to Albertans, and support continued industry investment, economic diversification and responsible development.

To achieve that objective, the Royalty Review Panel will undertake to:

1. Understand and assess the current Alberta royalty framework for each of the three distinct sectors in the province's oil and gas industry within the context of capital flows, available economic rent, employment, profitability, product competition for the attraction of capital, and government revenue.
2. Understand and assess how government revenue is generated from oil and gas land sales.
3. Understand and assess how a royalty regime can generate diversification opportunities, such as value-added processing, innovation or other forms of investment.

4. Understand and assess how Alberta's royalty framework compares with other jurisdictions.
5. Understand and assess the trends that are likely to affect the future (short- and long-term) for the three distinct sectors in the province's oil and gas industry, and their implications for government revenue.
6. Develop criteria for assessing the effectiveness of the royalty framework on an ongoing basis.

Developing criteria is an essential step to ensure that the royalty framework is durable and stable over the longer term and responsive to the ups and downs of the marketplace. One of the Panel's goals is to assure Albertans that a good framework has been put in place and they can be confident it will remain so.

THE PANEL

The Panel will consist of four members whose combined attributes cover the range of skills that will be required for this review. These skills include the ability to understand what is important technically, to capably consider the financial ramifications of the elements of the royalty framework, to critically assess complex issues and to develop sound public policy. The final and perhaps most crucial element will be the Panel's ability to engage all stakeholders in optimizing their interests in conjunction with others.

The Panel members will be:

Dave Mowat, Chair
President and Chief Executive Officer, ATB Financial

Dave Mowat is the President & CEO of ATB Financial, which, with assets of more than $43 billion, is Alberta's largest, provincially based financial institution. ATB employs almost 5,300 team members in 244 communities, providing personal, business, agriculture, corporate, and investor financial services to more than 710,000 Albertans and Alberta-based businesses.

Dave is an Albertan by birth: he was born in Calgary and raised in Sherwood Park. And he is an Albertan by choice: after getting a Bachelor of Commerce degree from the University of British Columbia and serving VanCity credit union as its CEO, he returned to Alberta, and now lives in Edmonton.

Over the last three decades, Dave has shaped and been shaped by every aspect of the banking world: venture capital markets, credit, retail, corporate, investments, and banking tied to each sector of the Alberta economy.

The thread that connects the various chapters of Dave's financial services career is a commitment to using his banking expertise and his networks to serve the greater good.

This is visible in the boards Dave sits on: STARS, Telus Community Foundation, Alberta Blue Cross, Citadel Theatre and the National Music Centre. And in the causes—he has served the United Way of the Alberta Capital Region as its campaign chair—he gives his time to. And it is apparent in the unique, community-building ventures that Dave and ATB help bring to life, including Empower U (a partnership that equips women with financial literacy skills), the ATB Financial Land Legacy Fund (a program that provides capital for purchasing land for habitat restoration before resale), and Light The Bridge (a citizens-led drive to raise $2.5 million to purchase and install LED lights on Edmonton's High Level Bridge).

That instinct for uplifting the community is reflected by the honours conferred both on Dave and the company he leads. He is Alberta Venture's Business Person of the Year. He has held the Charles Allard Chair in Business at MacEwan University. SAIT Polytechnic has awarded Dave an Honorary Bachelor of Business Administration degree. He was named to the Edmonton Journal's list of the city's Power 30 group. ATB was named one of the 2015 Best Workplaces in Canada by Great Place to Work, one of 2015 Best Employers in Canada by Aon Hewitt, and one of the Most Engaged Workplaces in North America by Achievers.

In business, in banking, in community, Dave helps open Alberta to the world of its potential.

In 2015, Dave Mowat was named chair of the Alberta Royalty Review panel.

Leona Hanson
Mayor, Town of Beaverlodge, Alberta

Leona Hanson is a seasoned business professional who has dedicated herself to the community for over two decades. She is currently the mayor of Beaverlodge, a town of 2,500 people 40 kilometers northwest of Grande Prairie.

She currently operates her own consulting business providing services to business and non-profit clients in a number of areas including business and human resources planning, account management, organizational reviews and operational planning. Leona was elected mayor in 2007 and acclaimed ever since. She holds an MBA in project management from Athabasca University.

Leona was the executive director of SMEDA Business Development Corporation, a Community Futures organization, for 17 years. In that role she led an organization committed to economic and community development through financing, training and coaching to small and medium-sized enterprise start-ups and expansions. She was subsequently an advisor to all Community Futures Development Corporations and Regional Economic Development Alliances across Alberta.

Leona is very connected to the small business community and has been for her entire career. She has seen firsthand the wide range of business that serves the energy industry in Alberta. Leona was selected for the panel for a number of attributes. She has a firsthand understanding of how the activities of the energy sector ripple throughout Alberta and particularly the rural parts of the province. She understands municipal and business finances well, and with eight years under her belt as Mayor, is skilled at finding consensus within varying viewpoints. She is smart and is a good listener which suits her well for the job at hand.

Peter Tertzakian
Chief Energy Economist & Managing Director, ARC Financial Corp.

Peter Tertzakian is the Chief Energy Economist & Managing Director at ARC Financial Corp., Canada's leading energy-focused private equity company, with $5.3 billion of capital across the eight ARC Energy Funds. He grew up in Edmonton and currently makes his home in Calgary.

With over 34 years of experience in both the energy and finance sectors, Peter plays a pivotal role on ARC's Executive, Investment and Strategy Committees. In addition, he is responsible for directing ARC's economic research and overseeing the publication of the *ARC Energy Charts*, a weekly journal on energy trends. His two books, *A Thousand Barrels a Second* and *The End of Energy Obesity*; both examine transitions of the global energy sector through economic, environmental and geopolitical pressures.

Peter has an undergraduate degree in geophysics from the University of Alberta, a graduate degree in econometrics from the University of Southampton U.K., and a master of science degree in management of technology from the Sloan School of Management at MIT. In addition to his principal role at ARC Financial, he has lectured at many leading universities and conferences around the world. His collective knowledge of energy innovation, history and economics gives audiences thought-provoking insights into today's pressing issues.

His career started as a geophysicist with the Chevron Corporation in 1982, where he spent eight years working in field operations, seismic data processing and geophysical software development. He moved from oil and gas to the financial sector in 1990. Since then, he has become a recognized analyst, economist and author who is routinely sought after as a speaker and educator. He is also an Adjunct Professor at the University of Calgary's Haskayne School of Business.

The panel appointed Peter for his passion for energy issues, his unique financial and operational expertise in the industry, and for his understanding of domestic and global economies. He has spent over 50 years in Alberta, has worked all across the province and understands the complexities of the exploration, production and transportation of its energy resources. He is an excellent fit for the panel.

Annette Trimbee
President and Vice-Chancellor, University of Winnipeg

Annette Trimbee is currently the president and vice-chancellor of the University of Winnipeg, a transformative downtown institution that serves nearly 10,000 students. Prior to this, her decades-long career in the public service of Alberta saw her hold a variety of portfolios as a deputy minister. A 2014 return to her hometown of Winnipeg brings her full circle; she is now leading the university she once attended as an undergraduate scholarship recipient.

Annette has served as the deputy minister of Treasury Board and Finance, Service Alberta and Advanced Education and Technology. She began her career in the public service with Alberta Environment and has also held leadership positions in Alberta Health and Wellness.

Her key accomplishments include the Alberta budgets of 2012 and 2013, aligning post-secondary system capacity through Campus Alberta, developing Alberta's Health Policy Framework, and building Alberta's integrated resource management framework and water policy legislation. She is currently working with the university's Board of Regents and a broad range of community stakeholders to set its strategic direction.

Annette holds a PhD in ecology from McMaster University, a MSc in botany from the University of Manitoba, and a BSc in biology from the University of Winnipeg.

Annette was selected to the panel for her deep experience in developing public policy along with the experience she gained as a deputy minister in key Alberta departments. She is smart, pragmatic, and a critical thinker who is intimately familiar with assessing complex issues. She believes that, as a university president, she has a responsibility to participate in work that has an impact on the wider world. She agreed to help tackle this task because of its significance to Canada, and in her own words: "I enjoy working with people to mobilize action towards a common cause."

RESOURCES

The Panel will have full access to the information and resources of the Government of Alberta and, as independent data or information from other jurisdictions is required, the Panel will be provided the resources to obtain it. The Panel will also invite industry, government and academic experts to contribute to and engage in the mutual understanding of the complex and varied nature of the topics to be considered. Three expert technical teams (for oil sands, crude oil and liquids, and natural gas) will be established to review and provide detailed analysis on key questions to be addressed as part of this review. These experts provide the Panel with a diversity of perspectives and they will be asked to participate on a "hats-off" basis. That is: to bring their expertise and work with other members to find workable solutions rather than simply representing a particular school of thought.

ENGAGEMENT

In the course of undertaking its review, the Panel will engage with Albertans, Aboriginal leaders, government, industry, and a wide range of non-governmental organizations including labour organizations, environmental organizations, and research institutes to gain a full perspective on questions the Panel has been tasked with addressing. A particular emphasis will be to engage as broad a spectrum of Albertans as possible, posing questions ranging from "what do you want to know about royalties" to "what types of assurance would you want to feel confident we have a sound royalty framework." To support that conversation, the Panel will provide Albertans with a series of facts and information about this most important and complex part of our economy. The Panel will use a wide range of tools and techniques to provide information Albertans can trust and engage them in conversation about what the Panel is learning. We believe that Albertans will welcome that source of information and the opportunity to gain a better understanding of our province's resources, the companies and people who develop them, and the impact they have on the economy. A key focus of the engagement process will be on confirming the criteria for judging the effectiveness of Alberta's royalty framework on a longer-term basis.

The process will be a conversation and will continue throughout the term of the review. It will involve a combination of face-to-face meetings, interactive web-based information and conversations. The objective is to be open and transparent not only about the process, but also about the information gathered as part of the review.

TIME FRAME

The Panel will undertake its work with a sense of urgency balanced with ensuring any conclusions it draws have been examined and discussed in sufficient detail to strike the optimal balance of the four objectives. We expect the Panel's work to be completed by the end of the year.

Work has already begun on developing a sound base of information on each of the three streams – oil sands, crude oil and liquids, and natural gas. A website has been established at letstalkroyalties.ca and, over the course of the review, additional information on a wide variety of questions related to royalties will be added to the website. Albertans will have the opportunity to learn more and provide input and ideas on an ongoing basis.

The Panel will engage with Albertans, industry and a wide variety of organizations and individuals throughout September and October. The Panel's target is to develop ideas for optimizing the royalty framework for consideration by government by the end of this year.

THE ENGAGEMENT PROCESS

If there's one thing we know about Alberta's royalty framework, it's that it is complicated, and understandably so. Alberta's energy industry is composed of three streams – the oil sands, crude oil and liquids, and natural gas. It's overly simplistic to suggest that there's one royalty framework that fits all of those streams or that you can simplify the conversation to fit all three. Combined with that reality is the understanding that there are trends and factors influencing each of the sectors that may not apply to all.

To address this complexity and to ensure that all the appropriate parties are engaged, the royalty review will proceed with a number of parallel streams.

A TECHNICAL REVIEW

It's essential to engage experts – people who understand how the royalty framework works now, why it was designed as it is today, what changes might be considered, and what the implications of those changes would be. The intent is to establish three technical and analytical working groups – one focussed on oil sands, one on crude oil and liquids, and one on natural gas. These teams will examine technical questions, provide a common base of information, and assess the implications of any changes that would be proposed.

INDUSTRY ENGAGEMENT

There are a number of energy industry companies and related associations that will be consulted and engaged in the process. This includes not only the largest oil and gas companies doing work and making investment decisions in Alberta, but also smaller industry players and the associations whose members are engaged in seismic operations, drilling, working in the oil sands, or supplying the necessary goods, services and infrastructure to support the development of Alberta's energy resources. These key industry players will be involved through conversations, meetings, providing information to inform the review and encouraging their employees to engage as individuals.

KEY STAKEHOLDER ENGAGEMENT

In addition to industry members, there is a wide variety of other stakeholders who are involved in, have a vested interest in, have ideas about the industry, or who are impacted by developments in Alberta's energy industry. This includes (but isn't limited to) Aboriginal organizations and leaders, labour organizations (many of whose members work in the energy industry), municipal organizations, environmental and research organizations, and other key community groups. These groups will be similarly engaged in conversations, meetings and in providing information to inform the review. They will also be asked to encourage their membership to participate as individuals.

ENGAGING ALBERTANS

The Panel will provide a variety of methods to engage as many Albertans as possible in a conversation about royalties. It will start with asking Albertans what they want to know about royalties and move through providing that information, to a discussion on what a royalty framework should accomplish. As owners of the resource, Albertans are looking for this opportunity to consider the options we have to optimize the returns to the province while also ensuring continuing industry investment, encouraging diversification and addressing responsible development. The Panel will provide a consistent and common foundation of information to enhance public understanding, not only of the royalty framework but, more importantly, how the royalty framework can create opportunities to optimize returns to the province, to industry, and to future development of the resource.

This engagement will be centred around a "conversation hub" all Albertans can visit at letstalkroyalties.ca throughout the review. There they can provide feedback directly to the Panel, answer questions posed by the Panel, and/or engage in a public online discussion. The Panel, and its individual members, will also seek opportunities to talk to and hear from Albertans – one-on-one and in group settings. The website will post a record of places the Panel has been and will be visiting, and what they are hearing. The Panel's determination to engage Albertans combined with tools now available to do that, promises to make this a very comprehensive process.

BUILDING AGREEMENT

The Panel will build consensus amongst key stakeholders on information, on the criteria for assessing Alberta's royalty framework, and on adjustments that can and/or should be made to achieve the objective set for the Panel. The Panel's goal is not so much a traditional report and recommendations as it is to build consensus on what opportunities there are to optimize and adjust the royalty framework as necessary to ensure it meets the objective. A report will summarize what the Panel learned and where there are opportunities for adjustments to the current framework.

Alberta