ALBERTA
ENERGY

Office of the Minister
MLA, Grande Prairie - Smoky

November 6, 2007 14873-28

Ms. Cindy Rutherford
President
Canadian Association of Petroleum Landmen
350, 500 - 5 Avenue SW
Calgary, Alberta T2P 3L5

Dear Ms. Rutherford:

Thank you for your correspondence regarding Alberta's royalty review. I appreciate you taking the time to share your perspective.

In recent years, Alberta has witnessed unprecedented growth in economic activity, jobs, and revenue generated by the energy sector. While this has brought prosperity to our province, Albertans have also asked whether we, as owners, are receiving our fair share from development of our non-renewable energy resources.

Following a thorough review and analysis of the data presented by the Royalty Review Panel, Premier Ed Stelmach determined that we can do better. The New Royalty Framework will maintain a healthy future for an industry that provides tens of thousands of jobs for Albertans and invests billions of dollars in our economy, while ensuring that Albertans receive a fair share from oil and gas development.

The Framework was designed to support a fair, predictable and transparent royalty regime while providing time for industry to adjust to the changes. The framework will provide certainty, and its sensitivity to commodity prices will assure investors that Alberta remains an internationally competitive and stable place to do business.

The New Royalty Framework takes effect in January, 2009. A lead time of one year is required to ensure the appropriate legal framework and administrative systems are in place. Changes to at least 11 laws and regulations will be required, including the *Mines and Minerals Act*, the *Petroleum Royalty Regulation*, the *Oil Sands Royalty Regulation* and the *Natural Gas Royalty Regulation*.

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404 Legislature Building 10800 - 97 Avenue, Edmonton, Alberta Canada T5K 2B6 Telephone (780) 427 3740 Fax (780) 422 0195
Constituency Office #105, 9804 - 100 Avenue, Grande Prairie, Alberta T8V 0T8 Telephone (780) 513 1233 Fax (780) 513 1247
Web Address: melknightmla.com

The Framework is the result of detailed study and analysis, as well as extensive public and industry consultation. Government thoroughly examined all the facts and data presented by the Royalty Review Panel, which were based on over 300 submissions received from a diverse group that included Alberta residents, municipal leaders and stakeholders in the oil and gas industry.

Nor did we stop listening once the formal consultation process was over. Premier Stelmach appointed the Honourable Ron Stevens, Deputy Premier and Minister of Justice, to provide industry with an opportunity to share its assessments of the impacts of the Panel's recommendations. My department led the technical analysis of the Panel's report to help decision-makers better understand the implications of their decisions.

The province also kept the communication channels open with Albertans. We received nearly 9,000 submissions via e-mail, telephone and written correspondence after the release of the Royalty Review Panel's report.

We recognize that high natural gas inventories and resultant low prices have affected exploration and development. While the New Royalty Framework may have some further impact on activity in the short term, the Framework will encourage prosperity and stability for the long term. It will help maintain Alberta's position as a stable and competitive place to do business.

I encourage you to read more about Alberta's New Royalty Framework at www.alberta.ca. Thank you once again for taking the time to write.

Sincerely yours,

Mel R. Knight
Minister

Alberta

News release

BUILDING TOMORROW

A PLAN to secure Alberta's future

October 25, 2007

Premier Stelmach delivers historic, new royalty regime for Alberta

New Royalty Framework gives Albertans their fair share; supports sustainable, vigorous energy sector

Calgary...Albertans will receive their fair share from the development of the province's non-renewable energy resources under a new royalty regime that also supports a robust, sustainable energy sector. Premier Ed Stelmach outlined his government's plan that will see Albertans benefit from increased royalties generated by an internationally competitive energy industry.

"I made a commitment and I delivered. Future generations of Albertans will receive a fair share from the development of their resources. I offer stability and predictability to those in the oil and gas industry, and the time to adjust to royalty changes. And I can also assure investors that Alberta will remain an internationally competitive and stable place to do business," said Premier Stelmach.

Alberta's New Royalty Framework fulfills Premier Stelmach's commitment to establish a regime that meets the needs of Albertans today and in the future. The new framework is based on input received from the public, industry, international experts as well as the report of the Alberta Royalty Review Panel established earlier this year.

Royalties are expected to increase by $1.4 billion in 2010, a 20-per-cent increase over currently projected revenues for that year. Actual revenues will depend on future prices and production levels in the province. Therefore, the Alberta government's annual budget development process will not change.

The new royalty regime includes the following components.

- New, simplified royalty formulas for conventional oil and natural gas that will operate on sliding scales that are determined by commodity prices and well productivity. The formulas eliminate the need for conventional oil and natural gas tiers and several royalty exemption programs.
- A sliding scale will be implemented for oil sands royalty rates ranging from one to nine per cent pre-payout and 25 to 40 per cent post-payout depending on the price of oil.
- The province will exercise its existing right to receive "royalty-in-kind" on oil sands projects (i.e. raw bitumen delivered to the Crown-operated Alberta Petroleum Marketing Commission in lieu of cash royalties). Because this bitumen can be sold or used for upgrading or refining, royalty-in-kind can be sold by the province to support value-added, upgrading projects in Alberta.
- The province will ensure that eligible expenditures and definitions of oil sands projects (also known as "ring fence" definition) that determine when a project has reached payout are tightly and clearly defined. Environmental "costs of doing business" will continue to be recognized as eligible expenditures.
- No grandfathering will be implemented for existing oil sands projects. The government is in discussions with Syncrude and Suncor, whose Crown agreements expire in 2016, to transition to the new oil sands royalty regime.
- Substantial legislative, regulatory and systems updates will be introduced before changes become fully effective in January 2009.

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In response to the panel's comments on accountability and to the recommendations included in the Auditor General's 2006-07 annual report, the government will initiate a review of all systems, structures and resources related to the collection and reporting of energy royalties. The project will be led by Former Auditor General Peter Valentine and it will be completed by March 31, 2008.

While many of the recommendations made by the Royalty Review Panel were accepted and will be implemented, a number of recommendations will be implemented with modifications and others have been rejected. The recommendation related to a tradable upgrader credit will be studied further in the context of the province's overall value-added strategy.

Implementing a new royalty regime is part of Premier Stelmach's plan to secure Alberta's future by building our communities, greening our growth and creating opportunity.

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Backgrounders: Highlights of Alberta's New Royalty Framework
History of Alberta's royalty regime and Mechanics of Changing Royalty Rates
Public Input—Royalty Review 2007

Media enquiries may be directed to:
Tom Olsen
Office of the Premier
780-422-4905
cell 780-718-3034

Jason Chance
Director of Communications
Alberta Energy
780-422-3667
cell 780-905-0294

To call toll-free within Alberta dial 310-0000.

Alberta

Backgrounder

BUILDING TOMORROW

A PLAN to secure Alberta's future

October 25, 2007

Highlights of Alberta's New Royalty Framework

Alberta's New Royalty Framework is the culmination of detailed study and analysis, extensive consultation, thoughtful deliberation, and a commitment to ensure Albertans receive their fair share from energy development. It represents fundamental change to current royalty structures, and based on current estimates, is expected to increase royalty revenues by approximately 20 per cent in 2010.

Conventional Oil

- The government will simplify royalties for conventional oil, eliminating specialty royalty programs and tiers. Royalties will be set by a sliding rate formula containing separate elements that account for oil price and well production. Royalty rates will range up to 50 per cent, with rate caps at $120 per barrel.

Natural Gas

- Gas royalties will be set by a sliding rate formula sensitive to price and production volume. New royalty rates will range from five per cent to 50 per cent with rate caps at $17.50 Cdn /MMBtu (Million British Thermal Units).
- The government will eliminate all tiers, but will retain natural gas programs for the Otherwise Flared Solution Gas Royalty Waiver Program, which improves air quality through solution gas conservation. New incentives consistent with the current Deep Gas Drilling Program will be implemented to support development of costly deep reserves.
- Royalties for natural gas liquids will be set at 40 per cent for pentanes and 30 per cent for butanes and propane.
- The government will continue to use deemed fees for gathering and compression in Alberta. It will move to a facility-level calculation for capital costs and continue to recognize actual costs for gas plant processing, where the cost differences are more significant.

Oil Sands

- The government will increase its royalty share from oil sands development by introducing price-sensitive formulas both pre- and post-payout, rather than implementing an industry-wide tax on oil sands production.
- The base royalty will start at one per cent, and increase for every dollar the world oil price, as reflected by West Texas Intermediate (WTI), is priced above $55 per barrel, to a maximum of nine per cent when oil is priced at $120 or higher. The net royalty will start at 25 per cent and increase for every dollar oil is priced above $55 per barrel to 40 per cent when oil is priced at $120 or higher.
- Government will work with Syncrude and Suncor over the next 90 days to reach an agreement on a transition plan to the new royalty framework. In the event an agreement cannot be reached, the government will take other measures to ensure a level playing field for all industry stakeholders.
- The government will adopt a permanent generic "bitumen valuation methodology" by June 30, 2008, after consulting with stakeholders and independent advisors.
- The government will comprehensively and extensively review and tighten, if required, current rules and enforcement procedures to ensure that absolutely clear, transparent, auditable and appropriate definitions exist for oil sands projects and eligible expenditures.

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- Companies with primary wells in areas designated as oil sands will continue to have the option of electing oil sands royalty status.
- The province will eliminate the provincial portion of the Accelerated Capital Cost Allowance consistent with the decision outlined by the federal government for oil sands projects.

Value Added

- By exercising its right to collect royalty-in-kind where feasible, the province will be able to receive raw bitumen in lieu of royalties, which can be sold to upgrading facilities in Alberta.
- The government will consider other ways to attract investment in the construction of additional upgraders and refineries in Alberta. This will include further study of an upgrader credit.
- The government will consult with industry on its options, determine the most effective approach, and announce its decision in 2008.

Accountability

- The government will assess and recommend improvements in the systems, structures and resources that support the collection, verification and reporting of energy revenues.
- Former Auditor General Peter Valentine will lead this project, which will begin in November 2007 and will be completed by March 31, 2008.

Freehold Mineral Rights Tax

- The current Freehold Mineral Rights Tax structure will not be changed, but will be reviewed to ensure it is fulfilling its intended objectives.

Timing

- With the exception of the accountability initiative, all changes will take effect on January 1, 2009.

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Jason Chance
Director, Communications
Alberta Energy
780-422-3667
cell 780-905-0294

To call toll-free within Alberta dial 310-0000.