Submission by the Alberta Federation of Labour

to

the Standing Committee

on Alberta's Economic Future

on

The Study of the BRIK (Bitumen Royalty-in-Kind) Program

January 31, 2013

Study of the BRIK Program

"Building Alberta's economic future requires more than just one BRIK"

January 2013

Introduction

Over the past few months, the price we get for our bitumen has been the subject of intense media scrutiny. Finance Minister Doug Horner recently said, "We're losing about $75 million a day to the economy."[1] In a televised address to Albertans, Premier Alison Redford said, "Historically, the price we receive for our oil has been a few dollars lower than Texas oil, and that differential had been manageable. But since September, that gap in the differential has grown considerably and the trend is getting worse for the foreseeable future."[2]

Given these comments, the Standing Committee on Alberta's Economic Future study on the Bitumen Royalty-In-Kind (BRIK) program is important and timely. Important in that upgrading our non-renewable resources to products with higher value products is a fundamental part of ensuring Alberta's economic health well into the future. And timely because the success of the BRIK program is "heavily dependent"[3] on a sufficiently wide differential price differential - the same differential Premier Redford is vowing to eliminate.

It's not only the BRIK program that's at stake. Increasing investment and job creation in our value-added industries also depends on a sufficient light-heavy oil price differential. A drastic narrowing of the price differential between blended bitumen and internationally traded oil will do serious harm to Alberta's value-added energy ambitions, as internal government documents show.

However, there's a silver lining to the current bitumen glut and the downward pressure that glut is putting on prices. The low price of blended bitumen relative to West Texas Intermediate (WTI) prices should actually be seen as an opportunity because it improves the economic viability of upgrading projects by driving down the cost for feedstock. In fact, as a result of the growing differential, the economic conditions for new upgrading capacity haven't been better in a long time. A large price differential and a high WTI price will mean windfall profits to producers that turn bitumen into synthetic crude oil (SCO) or higher-grade products.

But we need bold action to take advantage of it, and we need it now.

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[1] Emily Mertz, "Premier Redford drops more tough budget hints, but no details," Global News, Monday, January 14, 2013, http://www.globaltvedmonton.com/premier+redford+drops+more+tough+budget+hints+but+no+details/6442788389/story.html
[2] Government of Alberta, "Premier's address to Albertans," January 24, 2013, http://alberta.ca/Premiers-Address.cfm
[3] Government of Alberta, "Budget 2012 – Fiscal Plan," page 54, http://www.finance.alberta.ca/publications/budget/budget2012/fiscal-plan-revenue.pdf

The Alberta Federation of Labour (AFL) has long held the position that public investment is needed in order to ensure we get maximum value from our oil sands resources. A Crown Corporation, like Alberta Energy Corporation founded by Peter Lougheed, is the right vehicle for such a strategy.

The AFL recommends that the government commit to majority equity interest via a Crown Corporation for at least one new upgrading and refining petrochemical complex such as that recommended to the Department of Energy in 2006. The Government of Alberta has already drawn up plans. We have a blueprint – now let's get to work.

With more than a majority equity interest in major new infrastructure, a Crown Corporation could lead the way in all kinds of new ventures and partnerships for bitumen upgrading, refining, and associated petrochemical processes.

Direct public involvement in upgrading projects may seem like a big departure from the Alberta government's recent approach to the energy industry. But it is the only way Albertans will get a fair share of the value created through upgrading. If we don't take an equity share in future upgrading projects, the widening differential will likely encourage significant private sector investment in upgrading, but the public will get stuck getting low prices for our bitumen and the private investors will keep all the added value. We must think like owners, as Peter Lougheed urged, that is why public equity participation is a must.

The differential presents us with a challenge – and also a tremendous opportunity. It is time for the Province of Alberta to once again be bold in its approach to value-added jobs and economic development.

EXECUTIVE SUMMARY

AFL Recommendations to the Standing Committee on Alberta's Economic Future

1. Use the differential between Western Canada Select and West Texas Intermediate as an opportunity, not a disaster. The differential is key to Alberta's competitive advantage in building a value-added strategy for our natural resources.

2. Abandon the current policy of mindlessly chasing higher prices for bitumen. Our customers will never pay the same price for bitumen as conventional oil for a very simple reason: bitumen is not oil. The better answer is to create jobs and industry by selling a product our customers will pay top dollar for – upgraded Synthetic Crude Oil.

3. Stop stumping for bitumen export pipelines. It's part of the failed strategy of chasing the mirage of higher world prices for bitumen and will only exacerbate the problem of declining prices. More bitumen exports means more glut of supply on the world market, meaning a low price for the foreseeable future. If we focus on exporting SCO, we'll actually need less pipeline capacity because the SCO won't have to be diluted 30-50 per cent to move down pipelines, as bitumen is.

4. Create (or more properly re-create) an Alberta-owned energy Crown Corporation like Alberta Energy Corporation enter into joint project agreements with energy corporations to build upgraders and refineries. This is not nationalization – it is about using joint ventures to foster economic development. Without a publicly controlled energy champion, the interests of the owners (the public) always take a backseat to the interests of private corporations.

5. Deal with energy sector cost inflation by bringing the pace of oil sands development under control. Cost inflation for upgraders is one of the biggest obstacles for value-added projects. But pacing development will make those projects more affordable. Projects that are approved should require proponents to demonstrate Alberta-based upgrading as a condition of their approval.

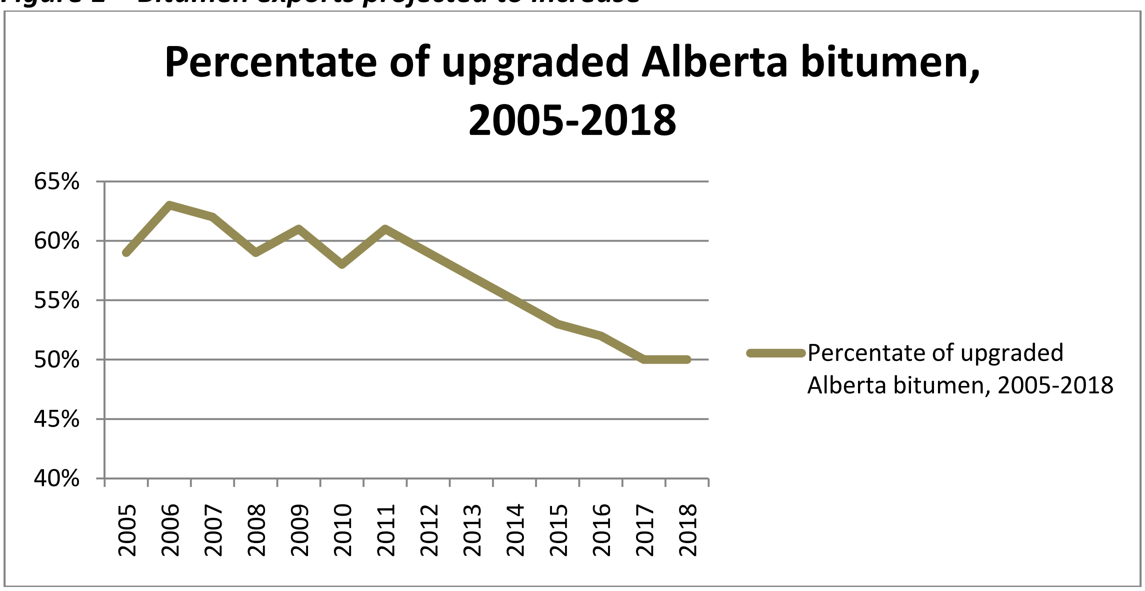
BACKGROUND
One BRIK is not enough

The BRIK program was part of the Stelmach government's promise to Albertans to increase upgraded bitumen up to 70 per cent of total production.[4] In order to reach this goal, Premier Stelmach said, "we need more upgraders coming online down the road, and we believe that ultimately through our BRIK program that will happen."

We're a long way from seeing Premier Stelmach's promise fulfilled. When the BRIK program was announced in 2010, 58 per cent of Alberta's bitumen was upgraded to higher value SCO.[5] According to the Energy Resources Conservation Board (ERCB), by 2017 we'll upgrade only 50 per cent of our bitumen.

According to the Government of Alberta's expert witness testimony before the Northern Gateway Joint Review Panel Hearing, Alberta will upgrade only 26 per cent of its bitumen by 2025.[6]

Figure 1 – Bitumen exports projected to increase



(Source: Alberta Federation of Labour through correspondence with the Energy Resources Conservation Board)

[4] Legislative Assembly of Alberta, Hansard, March 16, 2009
[5] Alberta Federation of Labour, "Alberta-based bitumen upgrading is plummeting, new figures show," July 19, 2011, http://www.afl.org/index.php/Press-Release/ab-based-bitumen-upgrading-plummeting.html
[6] Testimony of Dr. Harold York, Government of Alberta Expert Witness, under cross-examination by Alberta Federation of Labour counsel, Line 1755-56, Northern Gateway Pipeline Joint Review Panel, September 27, 2012. Also see: Wood MacKenzie and Associates, "A Netback Impact Analsis of West Coast Export Capacity." December 2011, Prepared for Alberta Department of Energy and submitted to the Northern Gateway Pipeline Joint Review Panel as Government of Alberta Evidence.

A BRIK in the Bucket

The upgrading capacity increase from the BRIK program is a drop in the bucket compared to increases in our bitumen production. The BRIK initiative will eventually add up to 75,000 barrels per day of upgrading capacity to Alberta by supplying bitumen to one upgrader, the North West Upgrader.[7] Meanwhile, some 216,476 barrels per day of bitumen production has come on line since 2010[8] and four upgraders have been shelved.

Just How Many Jobs Are At Stake?

Tens of thousands of jobs for Albertans can be created with more upgrading.

A single upgrader employs up to 2,000 workers. The eight upgraders that were slated for Edmonton were supposed to employ up to 12,000 people after construction. That is a massive – and stable – workforce.

Jobs in upgrading and refining are by definition good jobs. They are not short-term construction jobs – they are highly skilled and come with higher-than-average salaries.[9]

If the bitumen slated for export via the Keystone XL pipeline was upgraded and refined in Canada instead, it would create 18,000 permanent, direct and indirect jobs across the country.

If the bitumen slated for export via the Northern Gateway pipeline was instead upgraded and refined in Canada, it would create 26,000 permanent, direct, and indirect jobs across the country.

Instead, the Northern Gateway pipeline will, according to Enbridge's own evidence, give Alberta 24 permanent jobs and 204 in British Columbia. It's not a fair trade.

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[7] Government of Alberta, "Bitumen refinery agreement promotes value-added development," February 16, 2011, http://alberta.ca/acn/201102/299142F005558-0884-CE61-EBD4608FE8C36216.html

[8] Energy Resources Conservation Board, "ST98: Alberta's Energy Reserves & Supply/Demand Outlook 2012," http://www.ercb.ca/data-and-publications/statistical-reports/st98

[9] Todd Crawford, Conference Board of Canada. Canada's Petroleum Refining Sector; An Important Industry facing Global Challenges, October 2011.

Upgrading Puts Money on the Table: The Bitumen Bubble's Silver Lining Is Made of Real Silver

Oil industry's figures show Albertans lose 48 per cent of the value of every barrel of bitumen by sending the jobs and industry down the pipeline to the United States and China.[10]

Without upgrading and refining, Albertans also lose 57 per cent of the GDP potential and 57 per cent of oil sands jobs.

These are not figures generated by the Alberta Federation of Labour – they're industry's own numbers, generated by the Canadian Energy Research Institute.[11]

Seen in this context, it is no surprise Alberta has a revenue crisis. We've put all our eggs in the bitumen basket, but we've let the oil industry - controlled by American and Chinese oil companies - dictate how they'll hatch.

The Market Doesn't Want Bitumen, But We're Not Listening to the Market

The price of bitumen is low because there is too much of it on the market. US refiners don't want it – they would prefer conventional oil or Synthetic Crude Oil.

When faced with a low price, the natural thing to do would be to slow production until the market signals it wants more of the product.

Instead of regulating production with an eye on maximizing value, the Government of Alberta is responding to the low price of bitumen by flooding the market with even more of the stuff. The province continues to approve every oil sands project that crosses its desk without requiring upgrading to higher-value synthetic crude oil before the bitumen leaves the province.

No other oil-producing jurisdiction approaches its resources with this kind of self-defeating, counterintuitive strategy. Every other oil producing country in the world acts to maximize the value of their resources. This is why Middle Eastern countries formed OPEC, and why they've admitted other large oil producers to the club, like Venezuela. The whole point of OPEC is to limit supply to keep the price high and act in one's own self-interest.

Clearly, Alberta's strategy of taking its oil sands marching orders from industry is not helping the province. We need a new strategy that recognizes the importance of public leadership.

[10] Jeff Johnson, (PC MLA Athabasca-Redwater), "Upgrading Alberta's Future: Securing long-term economic opportunities through adding value to bitumen – A discussion paper," 2010.
[11] The Canadian Energy Research Institute (CERI), "Economic Impacts of the Petroleum Industry in Canada," 2009.

The Government of Alberta's Expert Witness at the Northern Gateway Hearings: We are selling the wrong product

Under questioning by counsel to the Alberta Federation of Labour, Government of Alberta Expert Witness Dr. Harold York outlined three options for alleviating the differential between WCS and WTI:

1. Slowing down the pace of production
2. Upgrading more to Synthetic Crude Oil, and selling that product instead, which is accomplished by requiring more upgrading in Canada
3. Repositioning Alberta refineries and putting refined products to market[12]

Cheap bitumen versus higher-value upgraded products

Premier Redford and Finance Minister Horner tell Albertans that the low price our bitumen fetches will cost our economy billions of dollars. Due to events beyond our borders, we're told, Alberta sits on an abundance of the stuff. That, coupled with our lack of access to other markets, means we might lose billions of dollars – up to $6 billion[13] - of resource revenues in this year.

But what Premier Redford and her ministers don't tell Albertans is that our customers don't really want bitumen. Bitumen is harder for refineries to process, and refineries need special equipment and expensive extra processes to make it into gasoline, diesel, or jet fuel.[14]

Regardless of whether our bitumen is upgraded in Texas or China, it will always fetch a lower price than WTI.[15] Bitumen upgraded to synthetic crude oil, on the other hand, sometimes trades at prices *higher* than WTI. [16] Also, since synthetic crude oil is priced against WTI, it would eliminate the kind of volatile price swings we often see with bitumen.[17]

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[12] September 27, 2012. Lines 1760-1778. Government of Alberta Cross-Examination by Leanne Chahley, Alberta Federation of Labour. Joint Review Panel in the matter of the Northern Gateway Pipeline.

[13] Government of Alberta, "Premier's address to Albertans," January 24, 2013, http://alberta.ca/Premiers-Address.cfm

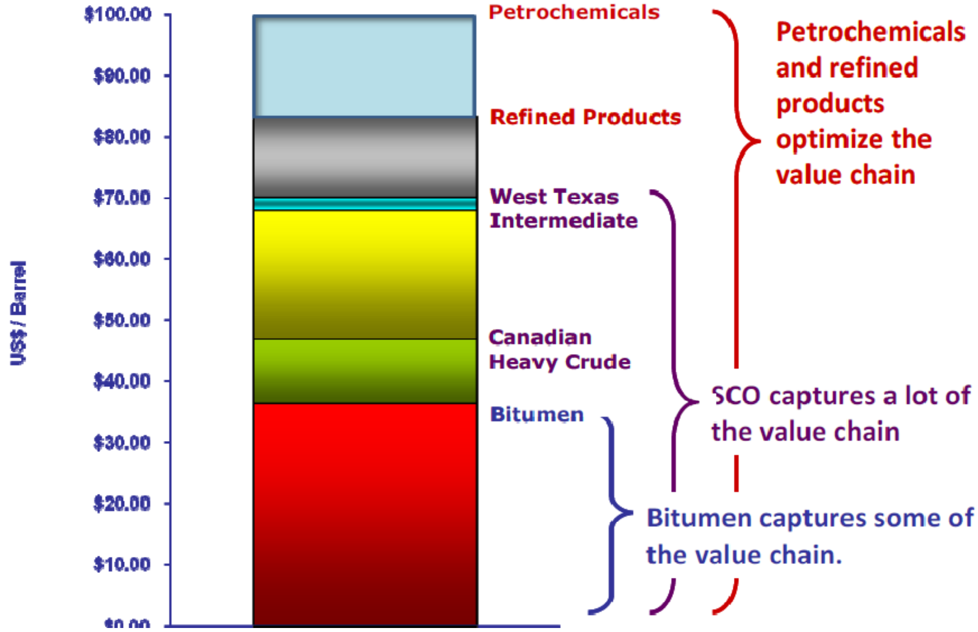
[14] The Government of Alberta, "A Netback-Impact Analysis of West Coast Export Capacity, Addendum Report for Alberta Department of Energy by Wood Mackenzie Inc, Responses to Information Request No 1, to Gitga'at First Nation," Page 1 of 12, Appendix A.

[15] Government of Alberta, "Energy Economics," page 9, http://www.energy.alberta.ca/Org/pdfs/EnergyEconomics.pdf

[16] First Energy Capital Corp, "Market and Commodity Prices," January 16, 2013, http://www.firstenergy.com/research/news/News-2013-01-16.pdf

[17] Government of Alberta, "Alberta's Value Added Oil Sands – Opportunities and Bitumen Royalty in Kind," September 2009, http://www.esc.ab.ca/doc/Sep09.GoA.pdf

Figure 2 – Alberta's value-added opportunity

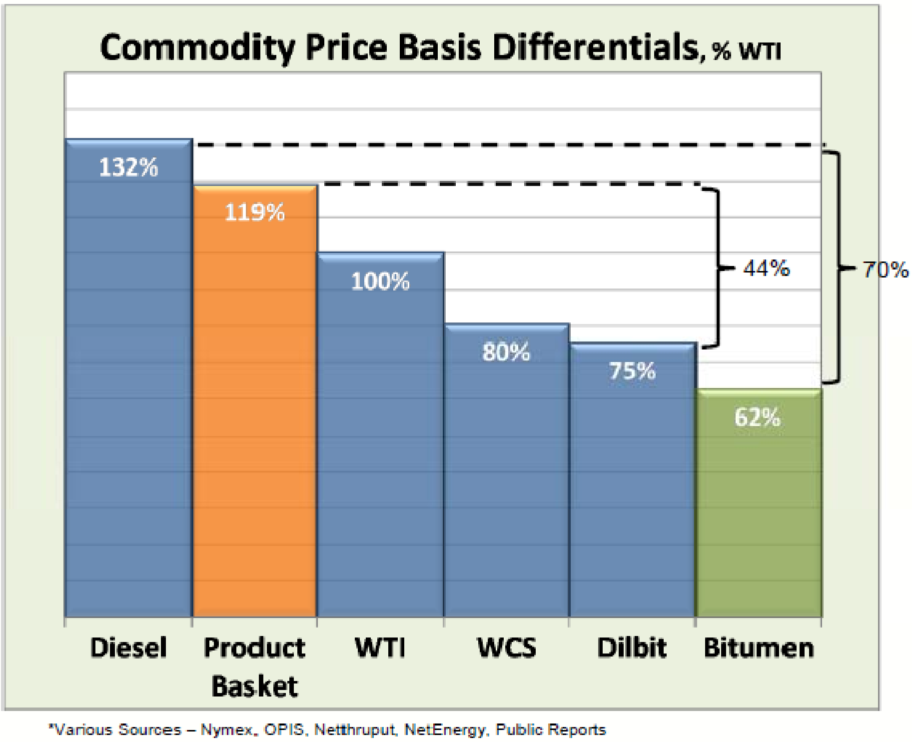


(Source: Government of Alberta, "Alberta's Value Added Oil Sands Opportunities and Bitumen Royalty in Kind," September 2009, http://www.esc.ab.ca/doc/Sep09.GoA.pdf)

As Figure 2 shows, we can gain even more value if we refine upgraded SCO to products like diesel fuel. A project like the North West Upgrader, which will get bitumen as part of the BRIK program, will produce value-added products like diesel fuel that are more valuable than bitumen or crude oil.

For investors in the North West Upgrader, it makes economic sense to upgrade to higher-value products. SCO will get WTI prices, sometimes more, while refined products will optimize even more of the value chain. According to North West's analysis, the product mix produced at that plant will get 132 per cent of the price of WTI, as opposed to about 80 per cent if blended bitumen were to be exported.

Figure 3 – Benefits of upgrading from the North West Upgrader



(Source: North West Upgrading, "Presentation to investors," November 2012, http://www.northwestupgrading.com/images/pdf/presentations/nwu%20investor%20pres%20nov%202012.pdf)

Upgrading economics: the silver lining of the bitumen glut

The government's inability or unwillingness to keep their longstanding promises on increasing Alberta's upgrading capacity, coupled with their 'rubber stamp' style approach to pacing oil sands development, have left us with a bit of a predicament. We're swimming in low-quality, low-price bitumen and we're getting much less value for the stuff than if we were to upgrade and refine to more valuable products.

There is a silver lining to this situation. The economic conditions have never been better for new upgraders and refineries.

The success of the BRIK program rests on a sufficiently wide WCS-WTI differential – as does that of any new upgrader in the province. It should then come as no surprise that internal government documents show the same thing: low-cost bitumen relative to WTI represents a tremendous opportunity for the province to encourage new upgrading capacity. The only surprise perhaps is that the Redford government doesn't seem to consider upgrading our bitumen as part of the plan to put Alberta on a stable financial footing.

Figure 4 – Oil sands break-even price summary

		L-H 35%	L-H 30%	L-H 25%	L-H 20%	L-H 15%	L-H 10%
Break-even Price	SAGD	$104	$85	$72	$63	**$56**	$50
	Mining	n/a	$107	$96	$86	**$78**	$71
	Integrated Mining	$84	$86	$88	$92	**$96**	$102

(Source: *Freedom of Information* request 2011-G-0054, Part 3, Page 660)

Figure 4 is an excerpt from documents the AFL received through a *Freedom of Information* request from a government study on oil sands competitiveness. It shows that as the light-heavy oil differential expands, integrated mining projects – those with upgraders – become more economically viable.

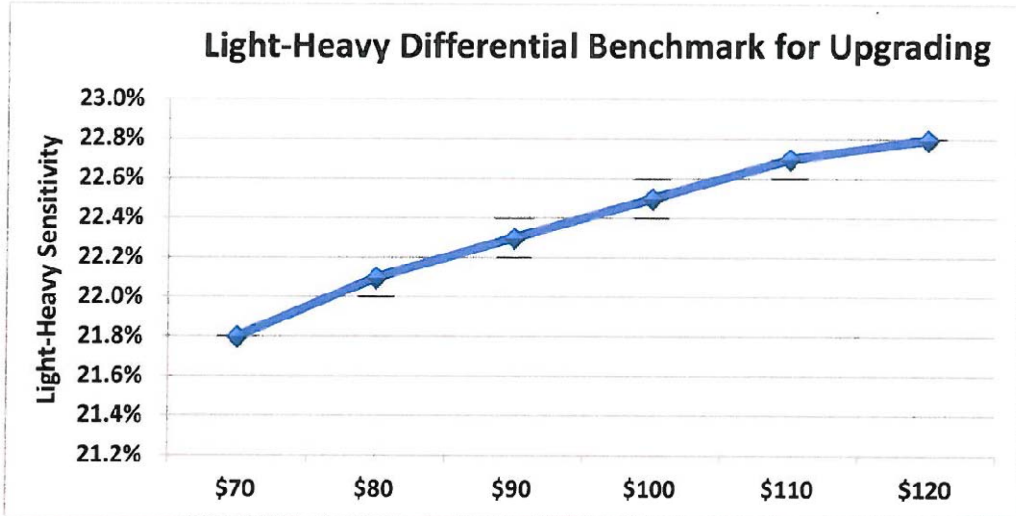
For SAGD projects, the opposite is true: these projects become less economically viable as the price difference between WTI and WCS expands. This is because SAGD and other *in situ* production methods produce bitumen, by and large, rather than higher-valued products like SCO.

The same government study notes: "At a 15 per cent light-heavy differential, integrated mining requires a WTI price of $96 in order to provide a 10 per cent return to the operator. Therefore, adding on additional upgrading facilities does not make economic sense under the current cost and price environment … Moreover, narrow light-heavy differential further exacerbates the economics of the integrated mining project."[18]

[18] *Freedom of Information* request 2011-G-0054, Part 3, Page 1360

Upgrading facilities do make economic sense with today's conditions. WTI averaged around $88 per barrel and WCS averaged around $57 a barrel, according to the government.[19] Those figures yield a light-heavy differential of about 35 per cent. Figure 5 below shows the threshold light-heavy differentials where it makes economic sense to build new upgrading capacity. A present-day 35 per cent differential is well within the economic threshold for adding new upgrading capacity.

Figure 5 – Upgrading or Not Upgrading



(Source: Freedom of Information request 2011-G-0054, Part 3, Page 1363)

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[19] Government of Alberta, "Benchmark crude oil prices," January 24, 2013, http://alberta.ca/albertacode/images/Benchmark-Crude-Prices.pdf

THE SOLUTION

Public Ownership, Investment, and Using Bitumen as the Bricks and Mortar for a New Petrochemical Industry in Alberta

The Alberta Federation of Labour submits the following recommendations to the Standing Committee on Alberta's Economic Future.

1. **Stop breaking promises.** The Conservatives have long held that upgrading two-thirds of our bitumen is their stated policy goal. We now upgrade barely in excess of 50 per cent and it is rapidly falling. By 2025, the Government of Alberta's internal documents show we will upgrade just 26 per cent of our bitumen. This runs directly contrary to what Albertans consistently tell pollsters and politicians they actually want. The Government of Alberta must listen to the majority of Albertans who want to keep good-paying oil sands jobs in Alberta and undertake immediate efforts for a truly value — added oil sands strategy, including new commitments to upgrading and refining.

2. **Make upgrading a condition of project approval.** Instead of allowing oil companies to do whatever they want with the resources that belong to us, require upgrading as a condition of project approval. Only approved projects that come with iron-clad guarantees of investment in upgrading, and actually enforce existing commitments to upgrading, such as the Fort Hills upgrader.

3. **Expand the Bitumen Royalty in Kind program immediately**. We now have a good example of what government could do if they were inclined to exercise leadership on upgrading — the North West Upgrader. Upgrading can be made economically viable with the right policy environment – so let's stop making excuses and do more of it.

4. **Be bold, and build on the Lougheed legacy**. Establish a public corporation – similar to the Alberta Energy Corporation – to partner with the private sector, and invest in upgrading facilities. Lougheed's approach to the petrochemical sector was correct, and built a world-class industry. In more recent times, Newfoundland and Labrador Premier Danny Williams took a similar approach, and transformed his province into a have-province for the first time in its history. Every other oil-producing country has a value-added strategy. We must think like owners, as Peter Lougheed urged, that is why public equity participation is a must.

   Why should Alberta be the only place to be left behind?

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