

# Keystone reignites debate over upgrading

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Renewed calls to process more bitumen in Alberta are following a delay in a proposed export pipeline even though the economic upside for upgrading plants in recent years has shrunk.

The push to encourage more processing of production from the province's vast bitumen resource into higher value light oil resurfaced this week in a debate among elected leaders, after the U.S. federal regulator deciding on a permit for the 830,000 barrel per day Keystone XL pipeline from Alberta to the U.S. Gulf Coast indicated it won't budge on its additional year or more of study.

The heightened pressure on lawmakers to get more revenue for Alberta's bitumen follows recent calls to address a predicted decline in synthetic oil produced in the province, as a percentage of total bitumen output. The Energy Resources Conservation Board predicts 47 per cent of bitumen produced in the province in 2020 will be upgraded to light oil, down from 58 per cent in 2010. In 2008, the province had set a goal of 66 per cent. The regulator's summer forecast had some eyeing jobs and tax revenue attached to additional upgraders crying out for government action.

Energy Minister Ted Morton told The Energy Roundtable conference in Calgary this week there has been "heated" discussion on the issue in caucus since the Keystone XL delay and there are some

"enthusiasts" in cabinet backing support for more upgrading, but that he isn't one of them.

Morton's view is that the economics for upgrading aren't certain and seem to change like the weather in Alberta, "every month or two," as he told an audience at the 2011 Calgary Energy Roundtable on Tuesday. Industry observers confirmed a confluence of factors make building a multibilliondollar upgrader riskier now than a few years ago.

Between 2004 and 2006, energy companies could earn 20 to 25 per cent more on each barrel of bitumen produced in Alberta by processing it into synthetic oil at an upgrader, said Kam Sandhar of investment bank Peters & Co. Today, a barrel of bitumen is only fetching 10 per cent less on markets than a barrel of synthetic crude.

A pair of new pipelines came online in 2010 to bring bitumen south to facilities that can handle the heavy oil, which lifted the price, Sandhar explained.

"What's changed between now and then is there's more take-away capacity to the Midwest, there's more coking capacity in the Midwest, which has essentially grown the market for heavy oil," Sandhar said.

While existing upgraders in Alberta are making money, Sandhar said, it's hard to justify new projects given that labour costs and supply chain costs have risen - including loftier steel prices. Expansion of oilsands mining and in situ bitumen production, expected to double from about 1.5 million barrels per day by 2020, means competition for workers in northern Alberta is fierce - which ratchets up wages, he said.

"Let's assume you heard somebody say tomorrow, 'There are two new upgraders being built,' " Sandhar said. "It's not doable."

The oilpatch is "clearly" supportive of doing upgrading in Alberta, said Greg Stringham, a vice-president of the Canadian Association of Petroleum Producers.

There are five upgraders operating in Alberta with capacity to process more than 1.2 million bpd, and a few more planned. North West Upgrading Inc. and Canadian Natural Resources Ltd. are pitching a three-phase project starting in 2014 to cost \$15 billion and amount to 150,000 bpd, with a bitumen supply commitment from the government. The proposed Voyageur upgrader by Suncor Energy Inc. and Total S.A. is projected to add 200,000 barrels per day in 2016. CNRL has said it would add to its existing Horizon upgrader facility, as long as cost inflation isn't too high, and Nexen Inc. has publicly mused about an upgrader expansion at its Long Lake in situ oilsands project.

Stringham said U.S. Gulf Coast refiners that can take in Canadian heavy oil have existing contracts soon expiring with suppliers from Venezuela and Mexico and are willing to pay more.

"So that's what you're competing against," Stringham said. Assuming Keystone XL gets built to supply those refineries, he said, that demand will be satisfied.

The Alberta Federation of Labour has long bemoaned export pipelines for allowing value-added jobs to flow "down the pipeline," the group's president, Gil McGowan, said. Even worse, McGowan argued, is that pipelines leaving Alberta have contributed to the

thinner profit margins upgrading projects could potentially earn by inflating heavy oil prices, leaving those profit spreads for refineries in Illinois to enjoy.

University of Alberta business professor Andrew Leach said the effect of pipelines on the economics of upgrading isn't so simple, since pipelines would also be needed to export new synthetic crude.

"Even if you are running 100 per cent synthetic in the province, you'd still want access to Gulf Coast or West Coast markets," Leach said.