

## Energy News

### Alberta's New Royalty Framework Transitional Offer

December 1, 2008

On October 25, 2007, the Government of Alberta announced the New Royalty Framework (NRF). The Framework was applicable to all wells and oil sands projects effective January 1, 2009. However, on November 19, 2008, in response to the global economic crisis and a slowdown in oil and gas drilling, the Government of Alberta announced a five-year transitional option (TO) to promote new drilling in the province. Additionally, on November 24, 2008, the Government of Alberta clarified that wells commenced between November 19 and December 31, 2008 would also be eligible for transitional royalty rates, making the Framework effective immediately.

#### What does this announcement mean for oil and gas producers?

In light of this recent announcement, producers now need to decide which royalty framework they want applied to each of their wells. Producers will need to consider many factors including:

- What are the short and five-year term reservoir and production estimates?
- What is the best option given the market volatility?
- Will the TO offset any pre-existing plans to move drilling activities outside of the province?
- How budgets and plans are affected by these changes.

- What systems need to be modified to accommodate the new TO and NRF?

The importance of these issues will encourage producers to develop a new decision model very quickly. They will need to opt for either program before the end of the year, and once a decision has been made, they will need to begin their transition by amending their systems, adapting their processes and procedures, and training staff.

#### Highlights and examples of the New Royalty Framework Transitional Offer

The TO is not an exemption from the program. It simply provides the oil and gas industry with a one-time option of selecting a transitional royalty program or immediately adopting the New Royalty Framework for eligible new wells. The wells that adopt the transitional rates will be required to shift to the NRF on January 1, 2014.

#### Eligible wells

- New conventional oil and gas wells for which staging, preparatory or initial drilling work has begun between November 19, 2008 and December 31, 2008;
- New conventional oil and gas wells and re-entry wells that commenced drilling (spud date) on or after January 1, 2009;
- Wells that have a measured drilled depth (as opposed to vertical depth) between 1,000 and 3,500 meters.

The five year transition option will apply to natural gas as well as field condensate production from eligible natural gas wells. Companies cannot elect for the option to apply only to a portion of the production from the well. Similarly, companies that choose the TO to apply to a qualifying oil well will also be subject to the TO for the associated natural gas production from the well.

The election must be made prior to a well being spudded on or after January 1, 2009. There appears to be no clear guidelines with respect to the election for wells spudded between November 19, 2008 and December 31, 2008.

Additionally, a company that opts for the Transitional Option cannot benefit from The Natural Gas Deep Drilling Program (NGDDP) or Deep Oil Exploration Program (DOEP).

### Ineligible wells

- Any existing oil and gas well or oil sands project; and
- Wells that receive benefits under NGDDP or DOEP.

### Transitional royalty rates

Under the NRF, conventional oil and natural gas royalty rates are based on formulas that are a function of price and production. The appropriate formula to calculate the monthly TO rate is determined by the range within which the Par Price (PP) established by Alberta Energy for that month falls and the range within which the well's actual production falls. For the new TO program, these ranges and other fractions within the formula have changed.

#### Example 1

If the Par Price of conventional oil is \$300 per cubic meter (approximately \$48 per barrel based on a conversion factor of 1 barrel = 0.1589 cubic meter) and 50 cubic meters (approximately 315 barrels) were produced per month, then the royalty rates under the NRF and TO options would be as follows:

#### Price Component ( $r_p$ )

$$\text{NRF: } r_p = ((300-250)*0.0010+0.0360)*100 = 8.60\%$$

$$\text{TO: } r_p = ((300-250)*0.0001+ 0.0140)*100 = 1.90\%$$

#### Quantity Component ( $r_q$ )

$$\text{NRF: } r_q = ((50-106.4*0.0026)*100 = -14.66\%$$

$$\text{TO: } r_q = ((50-30.4)*0.0013)*100 = 2.55\%$$

Therefore, the royalty rates (RR%) would be:

$$\text{NRF RR\%} = r_p + r_q = 8.6\% + (-14.66\%) = 0\% \text{ (as it is negative)}$$

$$\text{TO RR\%} = r_p + r_q = 1.9\% + 2.55\% = 4.45\%$$

#### Example 2

If the Par Price of conventional oil is \$426 per cubic meter (approximately \$68 per barrel) and 150 cubic meters (approximately 943 barrels) were produced per month, then the royalty rates under the NRF and TO options would be as follows:

$$\text{NRF RR\%} = r_p + r_q = 19.9\% + 4.36\% = 24.26\%$$

$$\text{TO RR\%} = r_p + r_q = 2.78\% + 15.548\% = 18.33\%$$

#### Example 3

If the Par Price of conventional oil is \$470 per cubic meter (approximately \$75 per barrel) and 150 cubic meters (approximately 943 barrels) were produced per month, then the royalty rates under the NRF and TO options would be as follows:

$$\text{NRF RR\%} = r_p + r_q = 22.1\% + 4.36\% = 26.46\%$$

$$\text{TO RR\%} = r_p + r_q = 3.0\% + 15.548\% = 18.55\%$$

The Alberta Government has indicated that due to issues of productivity and price, some wells are expected to move to the NRF instead of the TO. An example of this is demonstrated in Example 1.

### Election process

The process of finalizing the details around eligibility and the application process is underway by Alberta Energy (AE); however, AE has confirmed that wells that are spud on or after November 19, 2008 will be eligible to make an application. Eligible wells that have been spud prior to the application process being available will be allowed to make an application once that process has been determined. In the meantime, a declaration is not required (nor will it be accepted) but drilling can proceed.

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