Alberta announces new royalty curves and initiatives

June 17, 2010

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As reported in prior posts (most recently in April 2010), in 2009 the Alberta Government launched a competitiveness review of the 'New Royalty Framework' implemented by the Stelmach government only two years earlier. The results of that review, along with the Government of Alberta's policy response, were released in March, 2010 and the corresponding new royalty curves were to be provided prior to June, 2010.

As promised, on May 27, 2010, the Government of Alberta revealed its proposed changes to the base royalty curves for both conventional oil and gas, which are to take effect on January 1, 2011. The government also unveiled further initiatives, as a result of the competiveness review, intended to energize investment and encourage development of Alberta's unconventional and deep resource pools. The most significant of these initiatives are modifications to the Natural Gas Deep Drilling Program and the implementation of the Emerging Resources and Technologies Initiative.

Royalty curves

The changes to the oil and gas royalty curves are in keeping with the announcements previously made in March, 2010.

The maximum and minimum natural gas price royalty rates are now set at 36% and 5% respectively, with the maximum royalty rate being reduced from 50%. The maximum and minimum conventional oil price royalty rates are now set at 40% and 0% respectively, with the maximum royalty rate being reduced from 50%. For both oil and gas the royalty rate is the sum of a price component and a quantity component. In both cases the quantity component of the formula remains the same as under the existing New Royalty Framework. There are changes to the price component of the gas royalty formula to moderate the increase in the rate at prices higher than $5.25/GJ. Similarly, there are changes to the price component of the oil royalty formula to moderate the increase in the rate at prices higher than $\$535.00/m^3$. Due to the lack of change to the volume component, higher rate wells will experience only minimal impact in royalty rates as a result of the royalty curve changes.

The new formula will be applied to all Alberta Crown production, including production from existing wells, effective January 1, 2011. An exception is provided for production from wells that choose to remain on certain transitional royalty formulas, which will receive those rates until December 31, 2013.

Natural Gas Deep Drilling Program (NGDDP)

The NGDDP is now a permanent feature of the Alberta royalty framework. The program was initially implemented in 2008 with the intention of encouraging continued deep gas exploration by providing royalty credits according to the depth of the well. In addition to extending the term of the program indefinitely, the modifications to this program include:

- Reducing the qualifying vertical depth requirement from 2,500m to 2,000m;
- Off target wells and wells within one spacing unit of another well will receive the deep gas royalty credit;
- Multilateral wells will now qualify for the program;
- Removal of the $875,000 credit for wells that exceed 4,000m; and
- Wells drilled into pools discovered prior to 1985 will now qualify for the program.

These modifications are retroactive to May 1, 2010.

The Emerging Resources and Technologies Initiative

The Emerging Resources and Technologies Initiative is intended to encourage new exploration, development and production from deeper, higher cost natural gas wells; gas resources within coal seams; shale gas; and horizontal oil and gas wells. Recognizing that unconventional plays face higher costs and risks associated with production, additional benefits have been extended to accommodate these plays and speed up the return of risk capital.

Shale Gas New Well Royalty Rate - Wells that produce exclusively from formations defined by the Energy Resource Conservation Board (the ERCB) as shale will qualify for a 5% royalty rate for 36 producing months with no volume limit.

Coalbed Methane New Well Royalty Rate - Wells that produce exclusively from areas defined by the ERCB as coal will qualify for a 5% royalty rate for 36 producing months, with the volume limited to 750-million cubic feet (MMcf) of gas equivalent production.

Horizontal Gas New Well Royalty Rate - New horizontal gas wells (as defined by the ERCB) will be entitled to a new lower upfront royalty rate at the start of production. The maximum royalty rate imposed for the first 18 producing months, or 500 MMcf, is 5%.

Horizontal Oil New Well Royalty Rate - New horizontal oil wells or horizontal non-project oil sands wells (as defined by the ERCB) will be entitled to a lower upfront royalty rate at the start of production. The maximum royalty rate imposed is 5%, with volume and production month limits set according to the depth of the well.

These rates are retroactive and shall apply to all wells that began producing on or after May 1, 2010.

The Government of Alberta has stated that it will not review the Emerging Resource and Technologies Initiative until 2014 and has undertaken that it will provide industry at least 3 years notice at that time if it decides to discontinue the initiative.

Industry reaction

Generally speaking, and not surprisingly, the industry reaction to the announced reform has been positive. David Collyer, president of the Canadian Association of Petroleum Producers has said that the government kept its promise to make the province's regime more competitive. Similarly Gary Leach, speaking on behalf of the Small Explorers and Producers Association of Canada, stated that overall, he was happy with the announcement. We anticipate further announcements from the government over the next few months on some of the other issued identified in the competiveness review.

The author wishes to thank Evan Dickinson, Student-at-law at Stikeman Elliott, for his contribution.