

Royalty and Related Information Review

Updates

July 31, 2003

Royalty and Related Information Review (RRIR) Gas Royalty Regime Changes

The Department of Energy, in consultation with industry representatives, has proposed a phased release of the RRIR regime changes beginning in 2003 and ending in 2005. This proposed timeline will enable the department to ensure that critical interconnections with the Petroleum Registry of Alberta (formerly VIPIR) and other projects can be identified and coordinated. The RRIR Design Task Force will prepare a final report and present the completed initiatives to industry associations and department executives for approval.

The following is a status update on each of the RRIR initiatives and proposed changes:

13th Month Unit Operating Cost Rate (UOCR) Adjustment

In April 2005, MRIS will introduce a new methodology that is intended to calculate a more accurate Unit Operating Cost Rate (UOCR) that will apply to individual EUB facilities in the province. Prior year rate adjustments would not be incorporated into the UOCR calculation for the current rate year. Instead, a new process would determine and apply updated rates retroactively to the relevant owner volumes for each prior production year through an annual 13th month UOCR adjustment. Thus, each EUB facility will have its costs and revenues more closely match the actual business in a particular production year. This concept was introduced in the January 1998 Royalty and Related Information Review. A subcommittee, consisting of department and industry representatives, held meetings between August 1999 and December 1999 to discuss the business rules and processes. All recommendations were presented to and approved by the DOE Advisory Board. The RRIR Design Task Force is completing the details to implement this change.

Unit Operating Cost Rate (UOCR) Indexing

The RRIR Design Task Force identified the following problems and issues with the current UOCR methodology:

- Lack of credibility and not defensible
- Present claw back methodology (recapture) results in misalignment of the cost adjustments
- Complexity of indexing the UOCR
- Application of UOCR to in-stream components (ISC)
- No additional designated facilities have been allowed
- Need for delayed rates
- Complexity of the 13th month UOCR adjustment

Initially, the Crown indicated that the current index factor (GDP) used in the UOCR calculation may no longer be appropriate but could not properly evaluate this without actual cost reporting. The group identified the pros and cons of actual operating costs and UOCR. One option was to look at annual reporting of actual costs by facility cost centre (FCC) operators. Approval to expand the scope to explore this option was provided by the Canadian Association of Petroleum Producers (CAPP) and department executives.

Feedback from the Small Explorers and Producers Association of Canada (SEPAC) identified that actual cost reporting is not acceptable to small industry producers. Based on a comprehensive review of the issues, the RRIR Design Task Force began identifying other alternatives to full reporting of actual operating costs. Industry members met as a group to come up with additional options and proposed the Hybrid Model Alternative.

Hybrid Model Alternative

Designated EUB facilities would continue to have facility-specific UOCR calculated from the facility's actual processing, gathering and compression costs. Non-designated EUB facilities currently classified in one of the five UOCR plant type categories would have a new blended UOCR calculation based on actual processing costs plus surveyed gathering and compression rates based on new plant type categories (sweet, sour or dry):

- FCCs that have been set up to report processing costs associated with facilities classified by the EUB as gas plants (capable of extracting sulphur or liquids from gas) would begin to file actual operating costs annually on the AC4 document.
- For the remaining gathering and compression FCCs, a cost survey would be conducted whereby a representative sample of FCCs would be selected to file actual operating costs every five years, with a revised indexing methodology based on the year-to-year change at designated EUB facilities for postage rate updating and other amendments which may deliver a materially simplified gas cost allowance regime, improved accuracy and reduced risk to all stakeholders.
- The initial survey is currently being conducted in 2003, based on operating cost information for the 2001 and 2002 production years. The results of this survey will be used to establish average gathering and compression rates for the 2005 rate year, under sweet, sour and dry plant type categories.
- The next survey would be conducted in 2008, based on operating cost information for the 2006 and 2007 production years. For the periods in between the survey years, the gathering and compression rates for non-designated EUB facilities would be updated annually by an index based upon the weighted average of change in the gathering and compression rates for the designated EUB facilities.

The proposed change, if approved by the department and endorsed by CAPP and SEPAC, would commence with the 2004 allowable cost reporting year as reported in early 2005. The department will administer the operating cost survey. Industry representatives will have the right to conduct an external audit of the process at their expense. If it is not accepted and the UOCR process remains as it does today, the Crown will implement a sunset clause and request industry to report actual operating costs every 3 to 5 years.

Custom Processing Adjustment Factor (CPAF) Changes

Complete elimination of the Custom Processing Adjustment Factor is not acceptable to the department as the royalty impact would be significantly greater than originally forecasted. The position taken by industry is that full elimination of CPAF should still occur. Industry's Hybrid Model Alternative for operating costs initially included an elimination of CPAF based on an annual capital cost allowance threshold. However, this type of exemption has since been withdrawn as industry stated that there are not enough administrative savings to justify the elimination of CPAF based on the threshold concept.

Streamlining the Mechanics of Custom Processing Cost Claims

This initiative was expanded to include an evaluation of the unit operating cost recapture process. Changes to today's recapture process also depend upon which method is chosen to allocate operating costs. Other topics covered were the AC2 ownership and the ability to reallocate CPAF to other royalty clients (moved to Form/Submission Re-engineering). The item was considered completed by the group with an understanding that we may revisit some issues if consensus is reached on operating cost reporting. Depending on the direction taken on some of the regime change items, existing forms may be redesigned as business requirements become finalized and would be looked at as the last item.

Replace the Corporate Effective Royalty Rate (CERR) with a Facility Effective Royalty Rate (FERR)

Industry members of the RRIR Design Task Force have identified that a large portion of their current business involves swing gas activities. The complexities in reporting swing gas activities and the possible need to use ring-fencing to handle situations involving shallow gas under the proposed Facility Effective Royalty Rate (FERR) process would cause major concerns for industry clients. A consensus was reached among industry representatives that the Corporate Effective Royalty Rate (CERR) should be retained. This item is now closed.

Allowable Cost Definition

The department is currently reviewing the allowable operating cost definitions with the goal of improving the clarity of the existing guidelines. Analysis is also underway to determine if there are cost categories that should be added to, or removed from the existing list of allowable operating costs. The department reviewed the allowable operating cost definitions with the goal of improving the clarity of the existing guidelines. In June 2002, Allowable Cost Definition was put on hold until further resolution to the Hybrid Model Alternative because the outcome may impact the allowable costs.

Midstream Operator Process Review

On May 23, 2002, the department identified reporting issues and concerns, indicating that there is no easy way to enforce compliance upon these operators. Industry has indicated that they also have concerns with reporting and have requested the department work towards resolving these issues. After discussing the issues initially identified by midstream operators, industry producers stated concerns relating specifically to capital cost filings and the importance of submitting accurate and timely information, especially for the proposed cost survey. Some additional issues were raised concerning the cost survey. The department is seeking to establish a mechanism to encourage accurate and timely reporting for all clients and will continue working on changing current legislation in conjunction with the EUB to encourage accurate and timely reporting for all clients.

Minimum Royalty

The department completed a preliminary analysis of this initiative. If further analysis is required, industry clients impacted by the proposed minimum royalty administration (small producers) would be asked to provide input to determine the direction. At the September 12, 2002 meeting, the committee agreed to remove this item from the scope, as it was considered low priority based on the benefits that would be gained. Since Minimum Royalty primarily impacts small producers, SEPAC's agreement to remove this item from the scope finalized this topic and no further work is required.

Review of Decommissioning/Reclamation Costs Study

A department study, outside the scope of the RRIR Design Task Force, is being completed on decommissioning/reclamation costs.

Form/Submission Re-engineering

The committee has reviewed and agreed to several form/submission changes, contingent upon approval of the proposed Hybrid Model Alternative. If approved, the changes must coincide with the changes to the business rules and be implemented one year prior to the regime changes. The proposed form/submission changes include, but are not limited to:

1. AC1 – Remove ownership section and add additional reported facilities (2.10) to allow identification of multiple alternative locations where royalty is triggered
2. AC2 – Industry to provide capital submissions only when there are changes to capital, ownership or RUL and the department to calculate the capital costs from year to year
3. AC3 – Add the capability to reallocate custom processing allocations to 3rd parties. If volumes are reassigned through RMF2, operating costs associated are also reassigned.
4. AC4 – A separate submission is required to accommodate the gathering and compression data that will be obtained through the survey process. Reminder notices must accommodate the FCC population that is required to file actual operating costs (all processing types, and gathering and compression from designated facilities).
5. AC5 – Remove the requirement for authorized signatures by removing a system edit