

July 15, 2003

Attention: Manager, Production and Royalty Accounting

**Operating Cost Reporting Survey Request – Non Designated EUB Facilities
For Proposed Royalty and Related Information Review (RRIR) Initiative**

In January 1998, the Royalty and Related Information Review (RRIR) task force, a joint Industry-Government initiative, recommended changes to the administration of Crown royalties and the reporting of upstream production information.

Key recommendations were:

1. Develop a central petroleum information registry that would contain key gas and oil information;
2. Consolidate the reporting information required by the Ministry of Energy.
3. Streamline the reporting and calculation of Allowable Costs to achieve fairness and administrative efficiency.

Government and industry achieved the first two recommendations with the successful startup of the Petroleum Registry of Alberta (the Registry) in fall 2002.

The RRIR committee is currently reviewing the third recommendation. As reported in the *January and May 2003 Gas Royalty Information Bulletins*, a major proposal being considered would change the current unit operating cost rate (UOCR) regime so that it allows for greater alignment with actual costs.

The RRIR committee has modified the specifics of the proposed operating cost regime change since the update given in the *January 2003 Gas Royalty Information Bulletin*, but the principles remain intact.

Current Unit Operating Cost Regime

Designated EUB facilities:

Under the current UOCR regime, operating cost allowances for processing, gathering and compression activities at facilities with an EUB-approved design capacity greater than 3,000 10m³m³ of natural gas production per day that were operational at January 1, 1994 are based on facility specific unit operating cost rates calculated from the facility's actual costs.

Non-Designated EUB facilities

The operating cost allowances at non-designated EUB facilities are based on plant-type specific unit operating cost rates. Each non-designated EUB facility is classified as one of the five plant types, with a separate unit operating cost rate.

Prior-year rate adjustments are incorporated into the UOCR calculation for the current rate year, for both designated and non-designated facilities.

Proposed Change to Unit Operating Cost Regime

The RRIR committee determined that operating cost deductions for non-designated facilities should be more appropriately aligned with actual costs.

However, the committee agreed that while actual cost reporting would be the most accurate, it would create too much of an administrative burden to report actual costs for every facility cost centre (FCC).

After a lengthy consultative process, the committee has proposed the **Hybrid Model Alternative**. The proposed change, if approved by the Department of Alberta Energy and endorsed by the Canadian Association of Petroleum Producers (CAPP) and the Small Explorers and Producers Association of Canada (SEPAC), would commence with the 2004 allowable cost reporting year as reported in early 2005.

The Hybrid Model Alternative

Under this proposal, designated EUB facilities would continue to have facility-specific UOCR calculated from the facility's actual costs. (See Quadrants A and C of *Operating Cost Reporting Table* below.)

A 'hybrid' model has been proposed for the remaining non-designated EUB facilities currently classified in one of the five UOCR plant type categories:¹

- Facility Cost Centres (FCCs) that are used to report processing costs associated with EUB facilities classified by the EUB as gas plants (capable of extracting sulphur or liquids from gas) would begin to file actual annual operating costs. (See Quadrant B of *Operating Cost Reporting Table* below.) Refer to EUB *Guide 56, Volume 2* for definition of a gas processing plant.

¹ This is defined in Chapter III, Section 3.12 of the *Alberta Natural Gas Royalty Principles and Procedures September 1, 2001 edition*.

- For the remaining gathering and compression FCCs, an operating cost survey would be conducted whereby a representative sample of FCCs would be selected to file actual operating costs every five years.
- The initial survey would be conducted in 2003, based on operating cost information for the 2001 and 2002 production years. The results of that survey would be used to establish average gathering and compression rates for the 2005 rate year, under three preliminary plant type categories:
 - Sweet,
 - Sour, and
 - Dry (dry sweet gathering systems with sales). (See Quadrant D of *Operating Cost Reporting Table* below.)
- The next survey would be conducted in 2008, based on operating cost information for the 2006 and 2007 productions years. For the periods in between the survey years, the gathering and compression rates in Quadrant D would be updated annually based upon the weighted average of change in the gathering and compression rates in the designated EUB facilities (Quadrant C).

Prior-year rate adjustments would not be incorporated into the UOCR calculation for the current rate year. Instead, adjustments for a rate year would be made to the same rate year through a year-end adjustment process.

Under the hybrid proposal, the operating cost reporting population will be divided as follows:

Operating Cost Reporting Table – Hybrid Model		
	Designated EUB Facilities	Non-Designated EUB Facilities
Processing Facility Cost Centres (FCCs)	Quadrant A Actual Annual Operating Costs	Quadrant B Actual Annual Operating Costs
Gathering or Compression Facility Cost Centres FCCs	Quadrant C Actual Annual Operating Costs	Quadrant D Operating Cost Survey

Individual UOCR calculations will be done for each EUB facility in the Non-Designated EUB Facilities group. The resulting annual UOCR calculation would be based on actual processing costs plus gathering and compression rates from the survey results, based on the type of plant (sweet, sour, dry).

The Department of Alberta Energy will administer the operating cost survey. Industry representatives will have the right to conduct an external audit of the process at their expense.

Royalty Impact Study

In order to advance these recommendations through several royalty policy review processes within government and industry, the RRIR Committee is required to conduct a detailed royalty impact study.

In order to evaluate the potential royalty impact of the hybrid proposal, operators are required to report their actual operating costs for 2001 and 2002 for FCCs that are linked to the sample of EUB facilities that have been selected through a statistical selection process. The applicable production year(s) will be provided to those operators. The results of this survey will be used to establish an estimate of the potential royalty impact of the proposed changes to the UOCR process for non-designated EUB facilities.

If the hybrid proposal is approved, the operating cost information collected for gathering and compression FCCs would be used to adjust the 2004 allowable costs that would have been given in 2004 and to establish the average rates to be used for the 2005 rate year.

Supplemental Reporting Required From Facility Operators

As the effective year-end operator of Facility Cost Centres (FCCs) linked to EUB facilities selected for the impact study and operating cost survey, your company is, pursuant to section 48(1) of the Mines and Minerals Act, required to provide to the Department in accordance with the following instructions:

- a written return in the form of the Excel spreadsheet template, showing in detail the information required by the form in relation to the 2001 and 2002 total allowable operating costs for the FCCs listed on *Attachment 1*.

A listing of FCCs is provided for each production year. If you are not the year-end operator in both years, you will only receive the listing for the year that you operate.

If you do not operate for the entire year, you are to obtain the remaining operating costs for that production year from the previous operator and report them with your costs. Please review the information on the attachment for completeness and accuracy.

Attachment I Review For Completeness

If we have not included all FCCs that you operate for the surveyed set of EUB facilities, please identify the missing ones to the Department. They are missing from the list because they have been tied with other EUB facilities not part of the survey sample. If the missing FCC actually comprises part of the gathering and compression infrastructure of a surveyed EUB facility, it should be re-tied with the surveyed EUB facility. You must identify any missing FCCs to the Department and indicate the surveyed EUB facility it should be tied to and include its operating cost in the return. Missing cost information will result in understated UOCRs for all of industry.

To help you determine any missing FCCs for the surveyed EUB facilities, the Department has compiled [a listing of FCCs that may be incorrectly associated with non-surveyed EUB gathering systems, where the gathering systems have no gas royalty liable volumes](#). This listing is provided in the August 2003 Gas Royalty Information Bulletin.

Attachment I Review For Accuracy

If there is inaccurate FCC information such as the FCC on the listing is not part of the surveyed EUB facility, or you are not the year-end operator of the FCC, please contact the Department to remove the information from your submission request. See *Action Steps* section for Department contact.

Through this effort, you may detect cases where incorrectly tied FCCs have caused under reporting of gathering and compression costs to designated facilities in prior years. If you find FCCs in the listing that actually comprise part of the gathering and compression infrastructure of a designated plant, you must tie the FCC to the designated plant retroactively through normal filing procedures.

See *Alberta Natural Gas Royalty Principles and Procedures September 1, 2001 edition*, Appendices G and H for definition of allowable operating costs. Total allowable operating costs include overhead and working capital allowance in accordance with Chapter IV, Section 5.5, Part 2 of *Alberta Natural Gas Royalty Principles and Procedures*. Allowable operating costs booked in your General Ledger for the calendar years 2001 and 2002 are sufficient for this reporting purpose.

FCCs with Swing Gas Deliveries

If your FCC is involved in swing gas deliveries (i.e. delivering to multiple processing facilities) during the 2001/2002 reporting periods, please indicate with Y in the Swing Gas column on the Excel spreadsheet. The Department will request for the specific operating cost breakdown on swing gas deliveries at a later date. For the supplemental breakdown, operators may use any acceptable method of allocation to distribute the operating costs between the swing gas delivery facilities. The Department will review all swing gas deliveries.

FCC Classification Review Process

In order to enhance the accuracy of the survey process, it is important for FCCs to be properly classified as processing, gathering or compression. The classification of the FCC must be based on the type of EUB facility that the FCC is physically situated within. For an FCC to be classified as “processing,” the EUB facility that the FCC is physically situated within must be considered by the EUB to be a processing facility. The EUB defines a processing facility as one that is capable of extracting liquids or sulphur or both from gas. Refer to *EUB Guide 56, Volume 2* for detailed definition.

To ensure that the FCC types are accurate for the operating cost survey, you are asked to review the FCCs on *Attachment 1* and classify each as either processing, gathering or compression based on the type of EUB facility that the FCC is physically situated within. Generally, facilities located in the field are considered gathering or compression FCCs and facilities located at the inlet of plants such as an inlet compression facility, are considered to be processing. Any assets physically located within the plant gate boundary are also considered to be processing facilities.

For the facilities that have been selected for the operating cost survey, report the facility cost centre type (i.e. Processing, gathering or compression) on the field provided in the Department template.

At a later date, a separate classification review exercise on all FCCs will be conducted to ensure that all active FCCs are properly classified.

For questions regarding allowable operating cost eligibility or FCC classifications, please contact Chris Lawton, DOE @ (403) 297-6746, Chris.Lawton@gov.ab.ca

Template For Operating Cost Survey

You must contact the Department to confirm receipt of this letter and to obtain an electronic version of the operating cost reporting template (Excel spreadsheet) via email. A sample of the Excel spreadsheet is shown on *Attachment 2*. Please follow *Action Steps* section for instructions.

The operating cost information must be submitted to Will Wong by email, using the electronic template. The operating cost information is not to be reported on the AC4 form. The deadline for submission of the return in the form of the electronic template provided is October 31, 2003.

As the success of this joint industry/ government proposal depends on accurate reporting from selected operators, we need your commitment to this reporting requirement.

Operators who fail to submit the required return by the reporting deadline of October 31, 2003 may, pursuant to section 63(1) of the Mines and Minerals Act, be subject to a fine.

All submissions will be subject to audit by the Department.

Action Steps

1. Recipients must contact the Department either by telephone or email to confirm receipt of this letter and to obtain the operating cost reporting survey template. **Department Contact:** Edith Villarica @ (780) 422-9211, Edith.Villarica@gov.ab.ca
2. Review the EUB and FCC information on Attachment 1. Contact the Department on any incorrect or incomplete information. For example, you are not the operator at year-end of the FCC (incorrect information) or not all of the FCCs you operate for the EUB facility have been included on the attachment (incomplete information). Department Contact: Mary Carrie @ (780) 422-9261, Mary.Carrie@gov.ab.ca
3. Collect the required allowable operating cost and FCC classification information for the selected facilities and report the information on the provided operating cost reporting survey template (Excel spreadsheet). You may report the cost information at the EUB level rather than by FCC, if desired, however, the EUB level costs must be divided into processing, gathering and compression costs in accordance with the FCC types within the EUB facility.
4. Submit operating cost reporting survey file via email to the Department by October 31, 2003. Department Contact: Will Wong @ (780) 415-0755, Will.Wong@gov.ab.ca

If you require additional information concerning the regime changes, please contact:

RoseAnn Summers, DOE @ (780) 422-6684, RoseAnn.Summers@gov.ab.ca or
Dave van Kampen, Industry Committee Member - CAPP @ (403) 237-1016,
dvankampen@talisman-energy.com or
Corey Heerensperger, Industry Committee Member - SEPAC @ (403) 265-1177,
corey@heerco.com

Yours truly,

David Breakwell
Acting Business Unit Leader
Gas Development