Alberta announces new oil and gas royalty calculations

April 27, 2016

Introduction

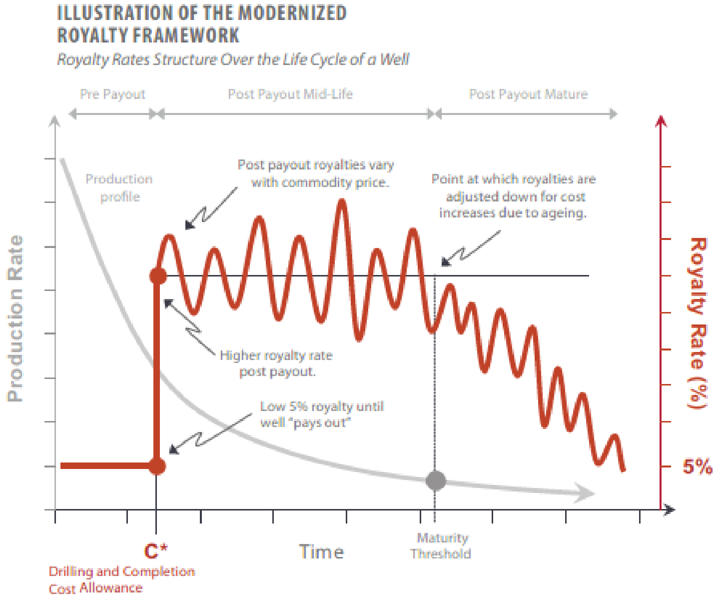
On January 29, 2016, Alberta's Royalty Review Panel issued its report (the Report) recommending a new modernized oil and gas royalty framework (the New Framework) which will apply to all new wells spud on or after January 1, 2017. Further discussion of the Report and the New Framework can be found in our February 1, 2016 article. At the time of writing our previous article, certain questions remained to be answered. These were:

- The post-payout sliding scale royalty rates that will apply to hydrocarbons other than bitumen;
- The formula that will be used to set C* (described below), including what capital costs variables are included as inputs for this formula; and
- The Maturity Threshold (described below) and royalty rate calculation that applies once the Maturity Threshold is met.

On April 21, 2016, the Government of Alberta released the after payout royalty calculations for: (a) conventional oil, pentane plus and field condensate; (b) natural gas (methane) and ethane; (c) propane; and (d) butane. Also announced was the calculation for C* and the Maturity Threshold for all commodities except natural gas. We expect the Government of Alberta to provide the natural gas (methane) and ethane Maturity Threshold in the coming weeks.

A key feature of the New Framework is the adoption of the concept of payout, on a "revenue-minus-costs" basis. Under the new framework, revenue is calculated by multiplying volumes of hydrocarbons produced by their respective par prices and deemed costs are based on C*. Wells will pay a flat 5 percent before payout royalty and an increased after payout royalty. The after payout royalty rate is determined by reference to the current commodity prices of the various hydrocarbons. Payout will be based on the Drilling and Completion Cost Allowance (C*, pronounced C-star) formula for each well. The C* formula will be based on the industry average drilling and production cost for any new well (the Alberta Capital Cost Index), which will be set by the Alberta Energy Regulator. Once production declines below a certain level (the Maturity Threshold), royalty rates will be adjusted downward in proportion to declining production.

The following chart, taken from the Report, provides an example of what royalties might be payable over the life of a given well under the New Framework:[1]



After payout royalties

The calculations for C* and the various after payout royalties can be found on the Alberta Department of Energy website by following these links:

- Calculation of C*;
- Conventional oil, pentane plus and condensate;
- Natural gas (methane) and ethane;
- Propane; and
- Butane.

Conclusion

At Dentons, we are monitoring developments in this area closely in order to provide our clients with practical analysis and market-leading advice.

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[1] Alberta Royalty Review Panel, *Alberta at a Crossroads: Royalty Review Advisory Panel Report* (2016) at p. 61

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