Alberta announces Petrochemicals Diversification Program

February 8, 2016

On February 1, 2016, the Alberta government announced a new initiative to encourage the upgrading of methane and propane in the province, called the Petrochemicals Diversification Program (PDP). Details of the PDP were issued on February 4, 2016. The PDP closely follows the public release of the Alberta Royalty Review Panel's Report of recommended changes to Alberta's oil and gas royalty framework (the Report).

One of the four recommendations made in the Report was for the government of Alberta to seize opportunities for value-added processing of oil and gas. In particular, the Report recommended that the province should develop a value-added natural gas strategy to "bridge the gap" in electricity generation while coal powered plants are phased out in favor of renewables. This strategy would also involve using natural gas as an input into other value-added sectors, such as bitumen upgrading, gas-to-liquids processing, fertilizers and consumer-oriented products, such as biomedical equipment and pharmaceuticals.

Building on these recommendations, the stated purpose of the PDP is to incentivize investment in Alberta's petrochemical industry, specifically methane and propane upgrading. The PDP will consist of CA$500 million in "royalty credits" being allocated to eligible petrochemicals projects, to be paid out over three years after the eligible project commences production, with a maximum of CA$200 million being allotted to any one project. These royalty credits can be traded with oil and gas producers. Producers can then use royalty credits to reduce the amount of royalties payable to the government on natural gas, natural gas by-products, or bitumen.[1] Based on the information available from the government at this time, it appears that producers' receipt of royalty credits will be tied to trading project feedstock for royalty credits. Further clarification is required on this point.

The government estimates that projects eligible for the PDP will represent between CA$3 billion and CA$5 billion in capital investment in the province. The PDP will help processers offset Alberta's high construction costs and incentive programs in other jurisdictions, and is expected to result in significant economic benefit to the province.

Project eligibility

The PDP application season runs from February 4, 2016 to April 8, 2016. To be eligible for evaluation, an application to the PDP must meet the following minimum requirements:

- The application's proposed facility or facilities must be physically located within Alberta;
- The application must include a continuous value chain that begins with consumption of either methane or propane as the primary feedstock in a primary facility to produce higher value products; and
- The application must be for a new greenfield or new brownfield (i.e. expansion) investment (excluding investment for the purpose of facility debottlenecking).

A PDP application can be made in respect of one or more facilities, and can be applicable to either "primary facilities," "secondary facilities," or a combination of the two. Primary facilities are defined as those which consume methane or propane feedstock for conversion to higher value products, the output of which can either be sold on the marketplace or consumed in a secondary facility. Secondary facilities are those downstream facilities, which use feedstock sourced mainly from primary facilities. Examples of secondary facilities include production facilities, polypropylene facilities, and propylene oxide facilities.

The award of PDP royalty credits is discretionary on behalf of the government. In order to be eligible, the government must be satisfied in its sole discretion that a project is in the public interest and is unlikely to proceed without program support. The government will identify the applications that offer the best overall return to Alberta, with regard to:

- Economic diversification through hydrocarbon value-added development, and other strategic objectives of the government, including environmental performance;
- Incremental revenue streams over time to the government and local jurisdictions (e.g. corporate income tax, personal income tax, municipal property tax, etc.);
- The economic benefits that a particular new facility brings to the provincial economy and local communities;
- The social and environmental impacts of the new facilities; and
- Any other factors the department considers relevant.

Further eligibility and evaluation criteria can be found on the Alberta Department of Energy's website.

Additional PDP details

Upon a successful application, the government will establish the number of royalty credits that will be available to a project. The project will earn these royalty credits—over a period of three years—through the consumption c feedstock in plant operations. Earning will be validated by the government through a prescribed bi-annual earned credit application process. Royalty credits will be assigned a value using the following formula:

Per Unit Royalty Credit Value = Annual Maximum Valuation / Expected Feedstock Consumption

Where:

- Per Unit Royalty Credit Value = royalty credit value per unit of feedstock consumed for a project;
- Annual Maximum Valuation = the maximum royalty credit dollar amount a facility is approved to receive on an annual basis; and
- Expected Feedstock Consumption = the volume of feedstock the facility is expected to consume in a calendar year based on the approval granted by the Minister of Energy in the application season.

Conclusion

The government anticipates that it will receive PDP applications for a number of projects, each valued at more than CA$1 billion in capital spend. Given prevailing economic conditions, it remains to be seen how many project proponents come forward to apply under the PDP. At Dentons Canada LLP, we are monitoring developments in this area closely to provide our clients with practical analysis and market-leading advice.

References

[1] If a processor is also a producer of natural gas, natural gas by-products, or bitumen, it may use royalty credits for its own account.

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