April 10, 2008

New deep resource programs promote high-cost oil and gas development

Announcement follows analysis of New Royalty Framework unintended consequences

Calgary... The Government of Alberta has introduced two new royalty programs designed to encourage the continued development of deep, high-cost oil and gas reserves. The resulting exploration and development are expected to generate additional jobs and royalty revenues for Albertans.

“The province is introducing these programs to enable producers to develop those oil and gas resources that are the most costly to access, but offer the greatest potential,” said Energy Minister Mel Knight. “These programs will help ensure that Albertans continue to benefit from the jobs, economic growth and royalties this development generates.”

The New Royalty Framework included a commitment by government to examine and address any unintended consequences in conjunction with industry. These programs respond to concerns identified by government about some deep oil and gas reserves that had the potential of becoming uneconomic to develop under the new framework, potentially causing a loss of industry activity, jobs and royalties.

As a result of the analysis of unintended consequences, the government is announcing two, five-year deep resource programs intended to increase development and generate energy royalty revenues. These programs will be implemented with the New Royalty Framework on January 1, 2009.

“Addressing the unintended consequences with these programs will help Alberta achieve the necessary levels of investment and production to generate the royalties anticipated by the New Royalty Framework,” Knight added.

This announcement follows the acceptance of the recommendations included in former Auditor General Peter Valentine’s Building Confidence report and the province’s renewed commitment to enhance the monitoring of the royalty regime and the reporting of those achievements back to Albertans.

Based on new, updated commodity price forecasts and anticipated production levels, the New Royalty Framework will meet or exceed the revenue expectations outlined when it was announced in October 2007.

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Backgrounder: Highlights of the new programs and other clarifications.

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Highlights of the new deep resource programs and other clarifications

Deep oil wells

- A five-year oil program for exploration wells over 2,000 metres will provide royalty adjustments to offset higher drilling costs and provide a greater incentive for producers to continue to pursue new, deeper oil plays.
- Wells deeper than 2,000 metres represented 20 per cent of oil wells drilled and 26 per cent of new conventional oil production between 2002 and 2007.
- Wells will qualify for up to $1 million or 12 months of royalty offsets, whichever comes first.
- The expected cost of the program is approximately $37 million a year for five years. This investment is anticipated to encourage development that may otherwise not occur, and is expected to generate $505 million over the next 10 years—a net benefit of $320 million in royalties.

Deep natural gas

- To encourage continued deep gas exploration, the government will replace the existing Royalty Adjustment Program with the Natural Gas Deep Drilling Program for wells deeper than 2,500 metres.
- Wells over 2,500 metres represented five per cent of natural gas wells drilled and 27 per cent of natural gas production between 2002 and 2007.
- The Natural Gas Deep Drilling Program will provide greater benefits to deeper wells, creating a sliding scale of royalty credit according to depth, up to $3,750 per metre.
- The expected cost of the program is approximately $200 million a year for five years. This investment is anticipated to encourage development that may otherwise not occur, and is expected to generate $1.51 billion in royalties over the next 10 years—a net benefit of $510 million in royalties.

Other clarifications as a result of the unintended consequences analysis

- Under the New Royalty Framework, four par prices instead of two will be used to calculate royalties on oil, allowing royalties to be charged at a price closer to that received by the producer.
- Natural gas royalty will be calculated based on the sum of vertical drill depth and all laterals, encouraging greater development of coalbed methane. Greater use of laterals may significantly lessen land use and the environmental footprint of CBM development.

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