



May 12, 2003

Alberta Energy and Utilities Board  
Applications Branch  
640 – 5 Avenue SW  
Calgary, Alberta  
T2P 3G4

Attention: Terry Abel, P.Eng.

### **GB 2003-12: GAS PRODUCTION IN OIL SANDS AREAS**

Canadian Natural Resources Limited (“CNRL”) is the second largest in-situ Oil Sands producer in Alberta. We currently operate 25 of the 60 oil sands projects recognized by the Alberta Department of Energy. CNRL is also one of the largest producers of natural gas in northeastern Alberta. CNRL’s total operated gas production within the Manville horizon of the Athabasca oil sands region is approx. 190 mmcf/day. Approximately 10% of this gas is produced concurrently with bitumen being produced under an oil sands production scheme approved by the Board. For CNRL concurrent gas/bitumen production affects 25,000 bbls/day of bitumen production. The decisions of the EUB (“the Board”) regarding gas or bitumen production in oil sands areas have a major financial and operational impact on CNRL.

With respect to the captioned General Bulletin, CNRL has the following concerns:

#### **1. Compensation:**

The Board’s powers and responsibilities to address issues of compensation are limited. However those of the Alberta Government are not. As an arm of the Alberta Government, the EUB triggers the issue of compensation with any decision that prohibits the production of gas from leases otherwise acquired by a developer from the Alberta Government. The EUB’s actions are not those of a remote unrelated third party in respect of whom the Government has no connection. Compensation is an integral part and an inevitable consequence of any decision of the EUB to prohibit gas production in respect of gas rights leased from the same Government that the EUB is a part of. Therefore a decision to shut-in production should not be made without consideration of compensation for the gas developers negatively affected by the decision.

The acquisition and development of a Crown gas lease is the result of a transaction between the developer and the Alberta Government, where the developer, in good faith and for fair consideration, pays for the rights leased and then invests considerable sums of money to develop and produce the gas reservoir

pursuant to those same rights. The Alberta Government receives substantial benefits from the developer's investments in terms of bonus payments, royalties, taxes and job creation. The developer enters into this transaction on the understanding that:

- it will be given a fair and reasonable opportunity to develop the rights that it has paid for; and
- that in accepting the risk of investing in the development of these rights it will not be subject to the unfair or arbitrary confiscation of its investment.

An order of the EUB shutting in existing gas production and prohibiting further development of existing Crown gas rights held by developers, is effectively confiscation of the investments made by those developers to acquire such rights and create such gas production.

It is understood by the developer that its rights and opportunities to develop a gas lease are subject to and limited by the laws and regulations of the Province. However at this time it is not the law of this land that rights acquired from the Crown and investments lawfully made in respect of those rights may be confiscated without compensation to the developer who has made such investments and hold such rights. The Government of Alberta recognized this in respect of the previous decision of the EUB regarding Surlmont after considerable and lengthy negotiation between the affected developers and the Government.

To proceed to impose a broader and far more significant decision to shut-in and prohibit gas production as contemplated in the GB 2003-12, triggers a massive requirement for compensation to the holders of the gas rights affected thereby. Therefore CNRL requests and recommends that:

- in parallel with the consideration and development of the order being contemplated by GB 2003-12, the Board, the Department of Energy and the gas and oil sands developers work in consultation to develop guidelines and rules for determining compensation where gas production is shut-in or prohibited; and
- the Board delay imposing a regime of gas shut-ins and prohibitions as contemplated by GB 2003-12, until rules and guidelines for compensation have been developed and are ready to be put in place.

## **2. Need For Certainty:**

Both gas and oil sands development involves long term planning and investment. The decisions made by developers today have major financial impacts on both the developers and the Province over many years to come. The process of deciding to invest or not invest in a gas or oil sands development requires an understanding of all of the costs and risks of the investment. The scope of costs and risks normally considered are:

- the geological risk of the reservoir,
- the market risk for substance being produced;
- the risk of the technology being employed;
- the risk of availability of the capital required for the development;
- the capital and operating costs of the development;
- the environmental risk posed by the development;
- the cost and risk of environmental remediation; **AND**

- **the regulatory risk of the development being constrained, limited or prohibited.**

Understanding and evaluating the last item demands that clear unequivocal rules be set out by the regulators and the legislators. Where the rules are subject to frequent change, or are vague, conflicting or inconsistent, a developer cannot properly assess their investment opportunity. This leads to reluctance to invest. For gas and oil sands developers to be able to effectively determine the regulatory impact and therefore the risk of developing either a gas field or an oil sands project there must be clear, consistent unequivocal rules that determine why, how and when gas production or oil sands production will be affected where bitumen and gas are found to exist in an oil sands formation

### **3. Fair and Responsible Development**

The Board's mandate regarding resource conservation is well understood. The Board's stated mission is also to "*ensure that the discovery, development, and delivery of Alberta's resources takes place in a manner that is fair, responsible and in the public interest*". The need to balance between gas production and the production of other resources is not new. Past experiences with having to balance between gas and conventional oil production, have generally been handled on a "case by case" basis, with the competing producers often participating in forming the solution through negotiation. The logic of the past practice is sound, since each reservoir and its development is unique. General principles applied to determine the outcome were based on a sound understanding of the impact of gas production upon the conventional oil reservoir. It was always recognized that the circumstances of each individual case needed to be analyzed and compared to the general principles before rendering a decision in a specific situation. Also the need to render a decision was only triggered when a producer sought the Board's approval to commence production from a reservoir.

In this instance the Board appears to be proposing to apply a general decision on a broad basis:

- where the understanding of the impact of gas production on bitumen production is not as well understood and significant differences of opinion exist among even the most seasoned experts; and
- where no consideration is being given to the characteristics of individual reservoirs or production practices and technologies.

Most of the debate regarding gas vs. bitumen production has focused on the impact on reservoirs being produced using SAGD technology. However most of the in-situ thermal production occurring in Alberta involves the use of cyclic steam technologies. The diversity in oil sands formations and bitumen qualities in Alberta is considerable.

Furthermore in the case of both in-situ thermal production and cold production, many of the existing oil sands projects are producing gas concurrently with the bitumen production. Were the Board to proceed to mandate a general shut-in of gas production in the Wabasca-McMurray formation, would the existing oil sands projects where concurrent gas production occurs be required to re-inject the gas being produced? If so, this would seriously impact the economics of the affected oil sands projects and could inadvertently result in the shut-in of bitumen production.

CNRL requests and recommends that the Board abandon the proposed approach of mandating a general shut-in of gas production in the Wabasca-McMurray formation, and instead:

- consider shutting in gas production in an oil sands reservoir, only where a bitumen production scheme is being applied for or approval to drill and produce gas from an oil sands formation is being sought and objection to the production of gas is being raised by an affected stakeholder;
- follow the practice of examining each reservoir in light of the characteristics of the reservoir, the bitumen contained therein and the production methods to be applied;
- establish a consultative approach whereby in each instance the holder of the gas rights and the holder of the bitumen rights are encouraged to develop a negotiated solution to the situation, which would then be reviewed and approved by the Board;
- establish a threshold test, whereby gas production from an oil sands reservoir will only be shut-in and prohibited where the value of the potential bitumen production exceeds the value of the gas production by a set margin;
- establish the principle that gas production concurrent with bitumen production will not be shut-in or prohibited; and
- establish as an overriding principle, that gas production will not be shut-in or prohibited unless there is a technically sound and economically viable bitumen project being proposed or executed.

Compared to conventional oil production elsewhere in the world, bitumen production is a marginal profit business. Limited markets, price competition with lighter crudes and substantially higher production costs (compared to production costs for competing lighter crudes) substantially impair the economics of developing Alberta's oil sands resources. Concurrent gas production is considered undesirable but unavoidable in those oil sands projects where it occurs. Usually the gas produced is marginally economic or uneconomic to produce, even though such production occurs concurrently with the bitumen production. In most cases, gas produced concurrently with bitumen, would not be economic to produce on a stand-alone basis. Requiring the shut-in of concurrent gas production would seriously impair the economics of the affected bitumen production and lead to the shut-in of a substantial amount of bitumen production.

The oil sands resources of the Province are vast. However only a limited portion of these resources are technically producible. Of the resources that are feasible to produce, only a portion of these are economic to produce. Even where economic bitumen production is feasible, it is not always the case that the bitumen production is of greater value to the public than the gas that may be produced from the same oil sands reservoir. In the case of in-situ thermal production it is not uncommon for oil sands developers to scale back steam production and postpone project expansion due to increases in the cost of the gas that they burn to produce bitumen. Were the situation otherwise, the magnitude and pace of oil sands development might be far greater than it is. This leaves the potential for significant gas production without consequence to real bitumen production potential.

To establish a general shut-in and prohibition of gas production from the Wabasca-McMurray formation, will rob the Province of the opportunity to optimize its gas production potential. To avoid such an error while proceeding with the intent of a general shut-in, the Board would have to undertake a broad and extensive study of the gas and bitumen production potential from this formation. This would require a

substantial expansion of the Board staff. Even with adequate staffing, given the length of time required to compile and analyze the data for the Surmont and Chard applications, the amount of time required to conduct a study of such a larger magnitude would be unreasonable. More importantly it is doubtful that such a study could be properly accomplished as there are vast areas of this formation where little or no useful data currently exists.

#### **4. Grandfathering**

The operators of existing gas developments have invested considerable time and resources to create value for themselves and the Province. These investments were made in good faith on the terms and conditions of the laws and regulations in place at the time. The Province has received funds in the form of royalties, taxes, rentals and lease bonuses from these gas developments. The operators of these gas developments agreed to pay these funds to the Province on the understanding that they would be able to develop, produce and sell the gas made available by their efforts and investment. The operators of these gas developments have performed their part of the contract with the Province. CNRL requests that the Board recognize the inequity of shutting in existing gas production unless and until a fair program of compensation has been agreed to between the operators of this gas production and the Province.

Should the Board elect otherwise, a clear message will be sent to all present and prospective investors regarding the development of Alberta's natural resources. The risk of loss of an investment due to Government action is a risk that an investor cannot predict, measure or hedge against. Such a risk is also a risk that a developer cannot accept. In a global economy, investors have a range of investment opportunities and investment flows to the areas where the balance between risk and reward is the most acceptable to the investor. Imposing a risk of loss of investment due to regulatory action tips the balance unacceptably suggesting that investment in development of Alberta's natural resources may be unwise given the alternatives.

It is our understanding that the Board's mandate includes not only resource conservation as it pertains to the public interest but also the obligation to consider the socio-economic impact of development. We would submit that in considering the proposed broad shut-in of gas production as contemplated by GB 2003-12, the Board must consider the socio-economic impact of its decision on the Province.

#### **5. Consistency**

In GB 2003-12 the Board proposes to address gas production from the Wabiskaw-McMurray formation only. CNRL believes that the impact of gas production has to be considered in any and all oil sands formations. Any protocol established by the Board to address the issue of gas vs. bitumen production should apply to all areas and formations where oil sands development may and does occur. CNRL would also point out that this issue should be of equal concern in oil sands areas where heavy crude oil is produced by primary production mechanisms. As the Board's primary stated objective is conservation, then CNRL believes that the Board should consider the implications of the problem in its entirety. To deal with only one formation and one type of production ignores the magnitude of the issue and an obvious

opportunity to more efficiently address and resolve the full spectrum of the problem. Surely it is not the Board's intent to leave room for unnecessary future rehashing of the gas vs. bitumen debate.

## **6. Expediency**

Recently the Minister of Energy proposed imposing a 6-month time limit for the review and determination of application for transmission development. CNRL applauds this proposal and strongly recommends its broader application to energy applications. The Board has made significant strides in improving the turn around on major oil sands mine applications. However in-situ projects continue to suffer from significant lengthy and unreasonable delays in the regulatory process. The hidden cost of such delays is investor reluctance to invest in-situ oil sands development. Regulatory delay is a real cost to the developer and must be factored into the economics of oil sands development. Continuing the tradition of multi-year approval processes for in-situ oil sands applications has and will continue to kill otherwise viable projects. CNRL requests that the Board establish and follow as a principle the same requirement and timing in respect to in-situ oil sands applications as the Alberta Government is proposing in respect of transmission applications.

Canadian Natural Resources Limited currently has 11 applications previously submitted to the Alberta Energy and Utilities Board for approval to produce gas from the Athabasca Oil Sands. Those 11 applications include 23 different wells, producing from a total of 28 zones, and account for approximately 8 mmcf/d of gross production (6 mmcf/d net to CNRL) which is being held up pending approval. Fourteen of the wells involved were drilled in 2003 and remain shut-in. The specific applications are Application #1294947, # 1298713, #1298422, #1294724, #1296027, #1297266, #1295421, #1298229, #1295427, #1293966 and #1296994 (submitted by Fekette Associates). CNRL understands that the Board will not approve or deny these applications until the issues canvassed in GB2003-12 have been addressed. CNRL respectfully requests that the Board expedite this process.

In summary CNRL firmly believes that the Board, the Department of Energy and the industry must cooperate to tackle this problem in its entirety with the objective of establishing fair, consistent rules and guidelines to address all aspects of the problem. CNRL would ask that the Board abandon the approach implied in GB 2003-12 in favour of supporting a broader dialogue with the industry and the Department regard solutions that address conservation, general Provincial economic and development policy, and compensation. As a gas developer CNRL cannot accept confiscation without compensation. Nor can we accept a sweeping general prohibition without strong evidence to support the need and fairness for such action. As an oil sands developer CNRL cannot accept only a partial solution. Issues of compensation for gas developers may ultimately be forced on the oil sands producer. The precedent has already been set by Surmont. CNRL needs certainty regarding any potential major cost impact on its oil sands developments. CNRL would prefer to resolve the issue through reasonable negotiation with all affected parties prior to proceeding with any further investment towards oil sands development in Alberta. Unilateral action by the Board without a solution for compensation will only engender conflict. Forbearance by the Board until a complimentary compensation scheme can be created, will engender confidence in the gas and oil sands development communities.

For better or worse, the decision of the Board regarding the proposal set out in GB 2003-12 will have an impact on the investment decisions of CNRL and all members of our industry. CNRL is dialoguing with other gas and bitumen producers, and is considering the formation of a broader coalition to represent a balanced view on the issues. However we remain independent in our position and views regardless of whether we elect to participate in a coalition or not.

Sincerely;

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Corporate Representative & Advisor  
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