



**Responsible Environmental Management of
Oil and Gas Activities in New Brunswick**

Sharing of Royalty Revenues From Natural Gas Activities
in New Brunswick

A Discussion Document

New Brunswick Natural Gas Group

May 2012

DOCUMENT PURPOSE

The purpose of this document is to provide an outline of the current policy thinking within the Government of New Brunswick concerning the sharing of the financial benefits that might be derived from an expanded natural gas industry, should one develop in New Brunswick. It is hoped that this document will stimulate comments and discussion that can be used to better formulate a policy that reflects the wishes of New Brunswick citizens.

All comments received about the proposals contained in this document will be reviewed and considered by Government. Once a review period has concluded, it is anticipated that the contents of this document will be finalized and subsequently implemented according to a schedule to be determined by Government.

BACKGROUND

The oil and natural gas industry has been contributing to the provincial economy for well over a century. Today, there are 30 producing natural gas wells in the Sussex area and 16 oil wells in the Hillsborough area. Currently nine companies hold a total of 71 oil and natural gas agreements covering more than 1.4 million hectares of land.

However, we now have the potential of an expanded natural gas industry due to new technologies enabling extraction of natural gas from shale rock. Beneath three-quarters of the area currently under licence for natural gas exploration, there is, as yet, no direct knowledge of the geology and shale gas potential. The potential for a large scale natural gas field is largely due to the size of the area and the known thickness of the hydrocarbon-bearing formation in areas where it has been assessed. Currently, planned seismic programs will help to refine drilling locations that over the next few years will start to confirm what potential lies in the subsurface of New Brunswick. In anticipation of this potential, the Government of New Brunswick has initiated a major effort to review its environmental protection standards for oil and gas activity, and to engage with the citizens of New Brunswick on the implications of this potential development.

This discussion paper suggests possible revenue sharing opportunities from this potential development of natural gas, should it ever occur.

INTRODUCTION

In the government's platform, *Putting New Brunswick First*, and in the Nov. 23, 2010, Speech from the Throne, commitments were made to assure New Brunswickers that any expansion of the natural gas sector would be conducted in a responsible manner. The Speech from the Throne also committed to a strong and parallel focus on the protective measures necessary to ensure responsible development. In response to this commitment, Government has released the document Responsible Environmental Management of Oil and Gas Activities in New Brunswick: Recommendations for Public Discussion.

On June 23, 2011, the Government announced its intentions to introduce a formula to ensure that local residents and communities share in the financial benefits associated with the development of the natural gas industry, if and when commercial production takes place.

For the purposes of this document and to assist the reader to understand the context, the following definitions are used:

- A royalty can be defined as a payment to a resource owner for an extracted resource belonging to that owner. In New Brunswick, the Province is the owner of the resource. (i.e. oil and natural gas).
- Revenue Sharing is the process through which the Government of New Brunswick would share the financial benefits derived from natural gas production with its citizens and communities by distributing a percentage of the royalties collected.
- Revenue Sharing payments are made by the Government of New Brunswick to communities and landowners.

The objective of this paper is to outline the Government's current thinking on how to distribute some of the financial benefits derived from natural gas production with its citizens and communities.

ROYALTIES

As part of the Natural Gas Development Action Plan, a review of the present onshore natural gas royalty regime was undertaken to ensure its relevance, considering New Brunswick's present stage of natural gas development. A number of factors were identified during this review that prompted the consideration of revisions to the present royalty regime;

1. Maximize a fair return to the Crown for New Brunswick's natural gas resource;
2. Recognize risk to investors in New Brunswick's emerging natural gas industry with Government sharing these risks, which enables Government to charge higher royalty rates; and
3. Be competitive with royalty regimes in other relevant jurisdictions.

The current royalty rate for natural gas is ten per cent of the actual selling price or fair market value at the time and place of production, whichever is the greater, free and clear of any deductions. The deductions mentioned in this section indicate that the field processing costs must be deducted before applying the rate. Under the existing royalty structure, there is no opportunity for the Province to benefit from high levels of economic profitability due to increasing commodity prices or lower production costs associated with a maturing industry.

The Government of New Brunswick contracted resource royalty experts to conduct a review of the province's royalty structures, to ensure appropriate resource royalty within a consistent framework and to ensure that New Brunswick is maximizing its revenues from resource royalties. The result concluded that the potential shale gas deposits in New Brunswick provide an opportunity for natural gas to generate significant revenue and contribute to the province's development.

Based on these considerations and following extensive analysis and discussions with consultants, government officials and industry, it is clear that the royalty regime in New Brunswick can be increased without harming the industry's competitiveness. The new royalty regime will be composed of two parts: a **basic royalty component** and an **economic profit royalty component**.

The basic royalty component is calculated much the same way as the current royalty rate mentioned above. The basic royalty component will be ten per cent (10%) of the actual selling price or fair market value at the time and place of production, whichever is the greater, free and clear of any deductions. This ensures a minimum payment to the province. However, on its own, the basic royalty component does not capture the true value of the resource as prices increase.

The economic profit royalty component is a resource rent royalty. A resource rent royalty

structure ensures that the resource owner maximizes revenue as prices increase and/or projects mature. Resource rent is the profit from a resource investment after the recovery of all costs, including an accepted investment allowance. The proposed economic profit royalty component is forty per cent (40%) of the profit from a resource investment after the recovery of all costs, including a return to the investor.

Revenues received from this royalty regime will be primarily used to benefit all New Brunswickers through investment in major government programs such as health care and education. As noted above, Government announced its intention to share some of the royalty revenue with landowners and communities.

REVENUE SHARING APPROACH

Sharing the revenues from royalties will be targeted at (1) landowners of residential property who 'host' a well pad or pads with a producing well or wells, and (2) municipalities and local service districts within a twenty-five (25) kilometre radius of the producing well pads.

Payments to the landowners of residential property and communities will only be made after the province receives royalty payments from the natural gas companies. These companies are required to make monthly payments to the province. The province will review and reconcile these payments and provide the funding to the landowners and communities on a semi-annual basis.

It should be noted that the Natural Gas Group is providing input into a broader Aboriginal Affairs Secretariat related initiative to determine how shale gas could potentially contribute to the First Nation economy in New Brunswick. This initiative will be managed separately and is not within the scope of this document.

HOSTING LANDOWNERS

Residential property for the purpose of sharing of royalties will be defined as property that contains a residence, cottage, apartment building, rooming and boarding house, mobile or mini home, any other single family or multi family residence, subdivided residential building lot separately assessed or farmland.

The amount of royalties to be shared with the landowner of residential properties hosting a well pad with producing wells will be one half of one per cent (0.5%) of the royalty collected from the producing wells situated on his or her property. In the event that a well pad with producing wells is situated on more than one residential property, the amount of revenue received by each landowner will be based on their percentage area of the well pad in relation to the total area of the well pad. The landowner will also receive compensation from

the natural gas company for allowing them to locate a well pad on their property. Revenue sharing payments to 'hosting' landowners of residential property with well pads and producing wells are provided by the province without conditions.

MUNICIPALITIES / LOCAL SERVICE DISTRICTS

It is proposed that the amount of royalties to be shared with municipalities and local service districts closest to a well pad be a total of two per cent (2%) of the royalty collected from the producing wells located within the province. For the purpose of this discussion document, closest to a well pad means those municipalities and local service districts within a twenty-five (25) kilometre radius of the centre of the well pad.

Revenue sharing payments to these municipalities and local service districts can be used for infrastructure projects that include, but are not be limited to, housing, road improvements, upgrading, extending or establishing water and waste water facilities, and recreational facilities.

AN OPPORTUNITY TO PROVIDE YOUR COMMENTS

Sharing of Royalty Revenues from Natural Gas Activities in New Brunswick: A Discussion Document has been prepared by the Natural Gas Group to assist the public in becoming familiar with the measures and recommendations being proposed and also to obtain public comment.

Comments can be submitted until July 18, 2012, by mail, fax or email using the following contact information:

**Natural Gas Group
1350 Regent Street,
Room 150
Fredericton, NB
E3C 1G6
Fax: (506) 453-3671
Email: naturalgas@gnb.ca**

An on-line form is also available and can be used to submit comments. The form and an electronic version of this document are available at: www.gnb.ca/naturalgas

There will also be a series of public events held beginning early in June. A schedule will be available on the website noted above.

Following the conclusion of the review period a summary of comments received will be prepared and posted on the above website.

EXAMPLES OF POTENTIAL REVENUE SHARING

The following tables are an example of what the revenue sharing with landowners and communities could entail. The numbers in this example are based on low natural gas prices (\$3.20 to \$8.75 per million cubic feet) with production from 100 wells per year with each well producing 3 million cubic feet of gas per day and a number of other variables. The amount per landowner is based on 10 wells per well pad. If any of these variables change, the amounts will reflect the change.

HOSTING LANDOWNERS

Revenue Sharing			
Year	Gross Crown Royalty	Landowner Share of Royalty 0.5%	Landowner Share of Royalty 0.5% per Landowner
	\$	Total	
2012	\$0	\$0	\$0
2013	\$0	\$0	\$0
2014	\$0	\$0	\$0
2015	\$14,891,753	\$74,459	\$8,366
2016	\$30,685,735	\$153,429	\$9,835
2017	\$51,252,895	\$256,264	\$10,998
2018	\$75,577,169	\$377,886	\$11,280
2019	\$111,096,620	\$555,483	\$12,770
2020	\$139,817,627	\$699,088	\$13,067
2021	\$167,858,017	\$839,290	\$13,217
2022	\$209,220,730	\$1,046,104	\$14,233
2023	\$249,568,090	\$1,247,840	\$14,944
2024	\$319,002,353	\$1,595,012	\$17,059
2025	\$678,853,799	\$3,394,269	\$32,795
2026	\$1,046,116,105	\$5,230,581	\$46,084
2027	\$1,235,327,611	\$6,176,638	\$50,013
2028	\$1,152,513,254	\$5,762,566	\$43,165
2029	\$1,460,398,296	\$7,301,991	\$50,885
2030	\$1,620,239,920	\$8,101,200	\$52,777
2031	\$2,276,144,728	\$11,380,724	\$74,141
Total	\$10,838,564,703	\$54,192,824	\$475,631

MUNICIPALITIES / LOCAL SERVICE DISTRICTS

Revenue Sharing		
Year	Gross Crown Royalty	Community Share of Royalty 2.00%
2012	\$0	\$0
2013	\$0	\$0
2014	\$0	\$0
2015	\$14,891,753	\$297,835
2016	\$30,685,735	\$613,715
2017	\$51,252,895	\$1,025,058
2018	\$75,577,169	\$1,511,543
2019	\$111,096,620	\$2,221,932
2020	\$139,817,627	\$2,796,353
2021	\$167,858,017	\$3,357,160
2022	\$209,220,730	\$4,184,415
2023	\$249,568,090	\$4,991,362
2024	\$319,002,353	\$6,380,047
2025	\$678,853,799	\$13,577,076
2026	\$1,046,116,105	\$20,922,322
2027	\$1,235,327,611	\$24,706,552
2028	\$1,152,513,254	\$23,050,265
2029	\$1,460,398,296	\$29,207,966
2030	\$1,620,239,920	\$32,404,798
2031	\$2,276,144,728	\$45,522,895
Total	\$10,838,564,703	\$216,771,294