

# NICKLE'S DAILY OIL BULLETIN

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[Contents](#) | [Previous Page](#) | [Next Page](#)

## Royalty Changes Essential To Cardium's Future

As promising as Alberta's Cardium play appears to be, some oil and gas industry officials and analysts say the provincial government must get it right in its pending competitiveness review and ensure that the play reaches its full potential.

In a recent report, **Macquarie Capital Markets Canada** said the Cardium currently exhibits competitive economics versus the other oil resource plays in the Western Canadian Sedimentary Basin (for example, Saskatchewan's Bakken, Lower Shaunavon and Viking plays); however, without the current royalty incentives, the Cardium ranks well below the Saskatchewan plays.

In June of last year, Alberta Energy Minister **Mel Knight** announced the extension of the province's drilling royalty credit and the new well incentive programs for an additional year. Both were initiated in March of 2009 but were set to expire in March 2010.

The drilling royalty credit for qualifying wells program provides a \$200 per metre drilled royalty credit to companies on a sliding scale based on their production levels from 2008.

The new well incentive program offers a maximum five per cent royalty rate for the first year of production from new oil or natural gas wells.

And while the temporary measures introduced by the province in the wake of its controversial New Royalty Framework have benefitted producers in the Cardium and helped spur on activity, the province must make the temporary measures permanent or introduce a more favourable royalty structure in order to fully maximize the potential of the play, says Macquarie analyst **Cristina Lopez**.

"The royalty incentives really make a difference on the economics so government really has to look at this and say, 'OK, we have to make this a competitive basin versus the other oil basins in North America and encourage drilling,'" she said.

"This is a high value product that ultimately leads to greater activity, greater employment and that all goes to the pocketbook of the province."

Using the Bakken as an analogue of the potential future pace of development in the Cardium, Lopez said Macquarie has plotted a theoretical production increase from horizontal, stage frac drilling activity in the play over the next several years.

"We expect activity targeting the Cardium to materially pick up next year and continue to ramp up in the coming years with un-risked production potentially reaching 85,000 to 120,000 bbls per day in five years," she said.

"Obviously it is still early stages for the Cardium and we expect to see large variability in results; however, recent success points to the vast potential and the possibility of repeating the Bakken's success."

But the province must get on board to make that happen, Lopez adds.

"Producers just have to have comfort in what the royalty regime will look like in the province because right now there's just a lot of uncertainty," she said.

The Alberta government is expected to release the findings of its competitiveness review in early to mid-February, said Alberta Energy spokesman **Bob McManus**. Premier **Ed Stelmach** has hinted there would likely be restructuring to the province's royalty scheme following the release of the document.

**Alberta Energy** led the study and received inputs from industry.

"We need to see a nimble royalty framework that provides the financial incentives, similar perhaps to what

Saskatchewan has for horizontal wells, to really make this opportunity in the Cardium take off in Alberta,” said **Gary Leach**, executive director of SEPAC (**Small Explorers And Producers Association of Canada**).

“The success in the Cardium will encourage interest and investment in other oil plays in Alberta long considered past their peak.”

[Contents](#) | [Previous Page](#) | [Next Page](#)

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