

Cost-Benefit Analysis – Tool

SCENARIO 3

Introduction

This Cost-Benefit analysis demonstrates (i) the process used by S Company and L Company to conduct the analysis (the "Process"), (ii) the issues that each Company wanted discussed and resolved, and (iii) the comparative costs-benefits that led S Company and L Company to choose mediation and arbitration as the most appropriate dispute resolution processes for their dispute. The numbers used do not need to be exact. They can be ball-parked to give the respective parties a sense of how much it will cost to pursue the dispute through the different dispute resolution alternatives.

The Process followed by L Company and S Company in this Analysis

The actual Process that L Company and S Company followed at their SITUATION ASSESSMENT MEETING (SAM) to assess their dispute and to select the most appropriate process to address and resolve their dispute evolved as follows:

1. S Company's and L Company's representatives met face to face in the SAM accompanied by their consultants and experts.
2. Also present were the parties' service provider and the neutral facilitator whom the parties had selected to chair the SAM.
3. On two large writing boards the facilitator (i) produced the Chart of Cost Factors below and (ii) attached a plan of the gas plant and related facilities, L Company's lands and wells and S Company's nearby undeveloped acreage.
4. The representatives of each party, who had not actually ever met face to face before the SAM, exchanged the usual cordialities and then, with the assistance of the facilitator, told their respective stories how the gas plant business fitted into their own corporate business plans.
5. In the course of their storytelling, the parties described the problems each faced with operations at the gas plant. With the assistance of the facilitator, a number of issues emerged and were identified. The facilitator noted these on the large writing board for all to see and so that they would not be overlooked or forgotten in the ensuing discussions. The issues identified for each of L Company and S Company are set forth below.
6. This process assisted L Company and S Company to select the most appropriate ADR process(es) that, on a comparatively favorable cost-benefit basis, offered the most likely opportunity for a mutually beneficial resolution of the dispute.

Issues

S Company: (i) drainage of its undeveloped lands; (ii) increased use of gas plant capacity; (iii) tie-in of its proposed offset wells to gas plant; (iv) reconfiguration (re-tooling) of gas plant to accommodate separate sweet and sour gas streams and to account separately for sweet and sour gas processing costs; (v) deficiencies in monthly

billing – accuracy, standards of accounting for costs and budgeting and what's going on; (vi) diversion by L Company of its capital away from gas plant; CO&Os Agreement requirement of agreement of both parties for gas plant enlargement/expansion, change of gas plant operator and capital expenditures.

L Company: (i) loss of autonomy if AEUB were to declare L Company a common processor/carrier; (ii) risk of AEUB rateable take orders applicable to natural gas from S Company's undeveloped lands and L Company's lands; (iii) determination of gas processing fees that L Company would be permitted to charge S Company for S Company's use of gas plant capacity owned by L Company.

Comparative Cost-Benefit Factors

This Chart shows the Cost Factors associated with the possible ADR processes that the parties might choose as the most appropriate and cost-beneficial. Below the Chart is an explanation of each Cost Factor and L Company's and S Company's analysis (in italics).

Cost Factors →	Internal Resources ⁽¹⁾	External Resources ⁽²⁾	Lost Opportunity ⁽³⁾	Time Value of Money ⁽⁴⁾	Other ⁽⁵⁾	Value/ Amount of Claim	Chance of Success ⁽⁶⁾	Total
BATNA	\$100K	\$275K	\$M	8 Mos.		\$1M	100%	(\$1M-375K) \$625K
WATNA	\$100K	\$275K	\$M	8 Mos.		\$1M	0%	(\$375K)
Facilitation								
Mediation	\$15K	\$9K			\$6K			\$30K
Arbitration	\$3K	\$12K			\$8K			\$23K
Hearing/ Litigation	\$100K	\$275K		8 Mos.		\$1M	80%	(\$800K-375K) \$425K
	CO&O made litigation problematic; and an AEUB hearing likely but, considering the BATNA/WATNA above, at comparatively much higher costs.							

BATNA/WATNA

Each of S Company and L Company considered its BATNA (Best Alternative To a Negotiated Agreement) & WATNA (Worst Alternative To a Negotiated Agreement), as their costs are usually beneficial in making decisions:

BATNA (Best Alternative To a Negotiated Agreement)

Negotiations are usually entered into to produce something of greater value than that available without negotiating. The BATNA becomes the standard against which a negotiated agreement should be measured. BATNAs require development and almost all the Cost Factors will be associated with them. For example, S Company's best alternative might be litigation or a hearing.

S Company did not, in this case, have to consider what it would do if it did not have either of the Hearing/Litigation options; but had it been otherwise, S Company would have.

WATNA (Worst Alternative To a Negotiated Agreement)

The WATNA is not only the opposite of the BATNA but usually clearly identifies the value of, or motivation for, negotiating. The WATNA often assists in establishing a party's "walk away". On the other hand, litigation or a hearing may be a party's worst alternative because there is no guarantee that the party will "win" or be successful.

Facilitation, Mediation, Arbitration and Hearing/Litigation

Identifying the costs of these various alternatives provides the opportunity for practical cost comparison. For example, the average costs for mediation (as outlined in the AEUB's ADR 2002 Annual Report) is \$3500.

S Company and L Company acknowledged that, while litigation might be an appropriate process, the existence of the CO&O Agreement and its requirement of unanimity of decision making made the outcome of litigation problematic at best. Both parties acknowledged that applications to the AEUB were more likely to be successful, resulting in a declaration that L Company, as the operator of the gas plant, is a common processor/common carrier, and drainage/rateable take orders respecting L Company's and S Company's lands. S Company viewed its chances of success to be better before the AEUB than litigation. L Company did not disagree and acknowledged, without prejudice, that it was significantly at risk and was not eager to be declared a common processor/carrier or to expose its wells and reserves to rateable take or other orders that might affect its autonomy and its privileges as operator of the gas plant. In addition to litigation or a regulatory hearing, the facilitator directed the parties' attention as well to other ADR processes that they should consider.

Internal Resources (Professional/Support/Clerical)⁽¹⁾

Costs associated with having professional internal resources (i.e. engineers, accountants, geologists, senior managers etc.) deal with the dispute which includes collecting and producing all supporting documents and time spent in instructing and managing outside resources (e.g. lawyers, consultants and experts). Wages, Supplies and Transportation directly associated are to be considered as well.

S Company and L Company acknowledged that a number of their respective professional and support staff would be required to prepare for whatever ADR processes (negotiation through litigation) might be pursued by either party. The issues that the parties identified and needed to have addressed would involve land, reservoir, plant facility-operating and accounting professionals and their respective support staffs. Estimates of the costs of these professionals and support staff working on the dispute (and, incidentally, not on their regular employment tasks) would likely result in an estimated 1,000 hours of attention by all internal staff assigned to the dispute at an average hourly rate of \$100/hr for each professional and his/her support staff, aggregating in total an estimated \$100K for internal resources. L Company estimated that its costs would approach this amount as well.

External Resources (Professional/Support/Clerical)⁽²⁾

Costs associated with engaging outside professional resources (i.e. as above, Legal, Experts, ADR service provider, facilitator, mediator, arbitrator). Wages, Supplies and Transportation directly associated are to be considered as well.

S Company, without in-house legal counsel and without plant redesign-operating capabilities, saw the need for retaining outside legal counsel, consultants and experts at significant cost relative to its cash flow. L Company, with superior resources, nevertheless acknowledged that it too would require outside resources. Both parties began to realize that litigation or an AEUB hearing could well result in a battle of lawyers, consultants and experts and a substantial commitment of their time. S Company estimated two counsel (senior/junior) would be required at a combined hourly rate of at least \$500/hr for preparation and hearing time in the order of 450 hours, totaling \$225,000. In addition, costs of consultants and experts were estimated to be \$50K.

Lost Opportunity⁽³⁾

Possible costs directly associated with the issues (i.e. loss of production). Costs associated with having to move or assign personnel from normal duties to deal with the disputes which may not add value).

L Company and S Company did not attempt to quantify lost opportunities caused by the dispute but recognized, particularly in the case of S Company, that delays in developing and putting S Company's proposed offset wells on production could be costly, potentially resulting in its undeveloped lands not being developed in a commercially acceptable period of time.

Time Value of Money⁽⁴⁾

Forecast of the costs associated with value in reaching settlement now versus waiting months or years to settle.

S Company and L Company estimated that the dispute might take up to 8 months to resolve but did not quantify this item.

Other⁽⁵⁾

Costs associated with engaging ADR resources: Service provider, facilitator, mediator, arbitrators.

L Company and S Company became increasingly interested in finding a more acceptable and cheaper process than an AEUB hearing or litigation to resolve the dispute. The facilitator outlined for them the nature of facilitation, mediation and arbitration. The parties concluded it was in their respective interests to try mediation of all issues but one. L Company was intractable regarding what it should be paid for allowing S Company to use L Company's owned gas plant capacity to process gas from the offset wells S Company proposed to drill on its undeveloped lands.

The parties agreed that the gas cost processing issue might best be resolved by an arbitrator having particular knowledge and expertise regarding JP90/95 gas processing

fee guidelines. The facilitator then gave an estimate of what arbitration of that one issue might cost and what mediation of the remaining issues might cost. These estimates were \$6K for mediation and \$8K for arbitration. The parties then added on costs of legal counsel, higher for arbitrations, and consultants and experts.

Chance of Success⁽⁶⁾

Likelihood of success is expressed in a meaningful numerical form (i.e. %, numerical scale). This percentage value should be assigned by external or internal legal counsel and applied to the amount or value of the claim, as well as, to the BATNA and WATNA. When using this tool, analysis can be made on the basis of each issue, the value attributable for each issue and the chance of success for each issue. In this scenario, S Company's counsel estimated an 80% chance of success at an AEUB hearing with a total value of the total claim being \$1M. When calculating the numbers, recognize that the internal and external costs incurred are not usually recoverable and should be deducted from the amount of the estimated claim that may be recovered, based upon the % factor of success assigned. It is recommended that this analysis be conducted separately by each of the parties prior to the SAM or in caucus during a SAM. Also recognize the % factor of success allocated by S Company's counsel may be different than L Company's counsel. These numbers are helpful parameters when the parties are negotiating or mediating with each other.

S Company received advice from its outside legal counsel and its consultants and experts that it had a strong case to make for favourable rulings from the AEUB.

THE FINAL RESULT

The outcome of this process and the agreements reached by the parties as to the most appropriate dispute resolution process was very revealing. The parties met for the first time, focused their attention on issues and not each other and emerged from the SAM with the most cost effective and likely beneficial ADR process(es) to address their problems and issues. In the final result, the parties met on a number of subsequent occasions and were able to negotiate a final, binding settlement that met their respective interests.