

Facility Fee Negotiations

(The Lost Practice)

In Western Canada, the commercial business of gas gathering, compression, and processing is fundamentally unregulated. It is left up to the owners of facilities and producers who wish to access these facilities to negotiate the terms for access; specifically cost, priority, and length of term. This process has been ongoing since custom processing first began in unregulated facilities in the 1950's and 60's. It has also created strife, industry infighting, concerns by the mineral rights owners and attempted interventions by the regulators. Only after a particularly aggressive round of fee practices by facility owners in the late 1980's did the industry and the regulators agree to the establishment of an industry-developed fee guideline to attempt to bring some discipline into the business without formal regulation. This industry-developed guideline, JP-90 and its successor JP-95, became the benchmark for the establishment of facility fees for the upstream processing industry.

The intent of the guideline was to act as exactly that – a guideline. The industry and the regulators recognized that there was no such thing as a “standard” facility fee, and that every processing circumstance was unique. Each facility fee determination required a set of negotiations to establish the circumstances for the fee applicable to that facility for that custom user. What the guideline did was twofold:

1. It provided the principles for conducting the negotiations to establish an appropriate facility fee, and
2. It determined the relevant range to establish the boundaries for the determination of fees.

So life in the custom processing world should be good, right? No Way!

Why?

The determination of fees based on JP-95 has its foundation in the Jumping Pound formula. The formula application requires agreement by the parties on specific methodology. The calculations are simple, once the data is known. The bust occurs when either party decides to apply its own methodology and in a manner that is completely favourable to its position, without first applying the basic principles of:

3. Collaboration

Disclosure

Negotiation

The end result is a position being developed that is completely offside with offside with JP-95 and totally unacceptable to the other party. This ultimately leads to the dispute landing in the offices of the regulators, who are bound to hear about the problems through complaints, applications, or hearings. This rarely happens, you say! Well, here are examples of some of the practices that many of us have faced in attempts to resolve facility fee disputes over the last several years since JP-95 was issued.

The Top Ten Abuses of JP-95 *

1. Return on Capital – Setting a high return on a parameter that is fixed under JP-95 (20, 25, 30, do I hear 40%)
2. Disclosure – Promoting fees that are “reasonable” but not disclosing the basis for the fees
3. Depreciation – Arbitrarily assigning depreciation rates depending on the age of the facility (“the faster the better, especially on new facilities”)
4. Lost GCA - worst case - trying to use it on a plant that is fully depreciated
5. Fixed fee at 1st year rates (maximum depreciation) - with no option to revise downwards.
6. Replacement cost - the facility is "reborn" each year with a new replacement cost
7. Complete disregard for JP-95 - "No one is going to tell me what I can charge for my Plant - let them build their own"
8. Design capacity versus throughput - not the same in many cases but used interchangeably where advantageous
9. Good old days - "it's the way we've always done it. Why should we change now?" (alternative - "it's too hard for the accountants to charge different fees")
10. Nova Complex - "it's a postage stamp fee" (for 1 mile or 20 miles - but set the fee at the 20 mile rate)

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These examples have one strong undercurrent: the failure by parties to collaborate and disclose information before negotiating a facility fee.

We do not operate in a perfect world. The oil and gas industry, by its nature, is a competitive business. Fierce competition in the exploration sector often carries over into the production and processing sector. To many companies, the concept of collaborating with and disclosing to its competitors is as appealing as eating maggots for breakfast. However, when you stop and think about the alternatives: heated battles, soured relationships, regulatory intervention, delays, plus the COSTS of the disputes (lost fees, lost production and wasted manpower), collaboration and disclosure become more attractive. This is why the guidelines were laid out in the manner that they were; to create a framework for the negotiation and resolution of fee issues, before they become costly.

There is always the alternative that the industry was threatened with in 1989, and that is the regulation of the facility fee business for the upstream industry. We didn't want it then, and in a regime where we are tending to more deregulation

than regulation, we don't want this alternative now. We have a guideline; lets make it work.

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