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Northeast Alberta Gas / Bitumen Update

1. Existing Gas Shut-in

In compliance with Alberta Energy and Utilities Board (“EUB”) General Bulletin 2003-28, in August 2003 gas producers were forced to evaluate their gas production in the Athabasca Wabiskaw-McMurray region and identify if gas production from grandfathered wells might be interpreted to create a potential risk to ultimate bitumen recovery by the guidelines of Interim Directive ID 99-1. Any gas which might be deemed associated was ordered shut-in on September 1, 2003. Gas producers shut-in 95 MMcf/d of production at that time.

2. EUB Issues Regional Geological Study (“RGS”) – January 2, 2004

The Alberta Energy and Utilities Board (“EUB”) released the Athabasca Wabiskaw-McMurray Regional Geological Study (“RGS”) pursuant to General Bulletin (GB) 2003-28. The objective of the RGS was to identify which gas pools are potentially in pressure communication with stratigraphic units that contain bitumen exceeding 10 metres combined thickness within a part of the Athabasca Wabiskaw-McMurray deposit.

The study identified 464 gas pools considered to be associated with bitumen. If all of the gas zones deemed associated by the RGS were ultimately ordered shut-in, this represents an additional shut-in of approximately 127 MMcf/d of natural gas production which may be ordered shut-in beyond the 95 MMcf/d the gas producers shut-in on September 1, 2003, for a total of 222 MMcf/d of possible gas shut-in. Total production from this region prior to September 1, 2003 was approximately 250 MMcf/d, representing approximately 2 percent of Alberta’s total gas production. There is a significant deviation from the many independent gas producers interpretation and the EUB’s interpretation of this matter.

Such identification and the manner in which it was made have raised serious concerns with respect to the next steps to be taken by the EUB. If the gas pools currently identified by the Board as associated were to be simply recommended for shut-in, this would be a significant deviation from Industry’s interpretation of the nonassociated gas presented through their exemption applications on September 1, 2003. With the disputes that are clearly looming, the extremely abbreviated review and limited hearing process outlined by the EUB to deal with the inevitable appeals to the shut-in order is definitely prejudicial to gas producers.

3. Technical Issues

The results of this study rely heavily upon geological correlation techniques to infer pool connectivity, without ever proving such connection. Notably absent from the RGS was the integration of engineering data that is critical to determine pool connectivity. The EUB Pool Orders released concurrently with the RGS include a drastic areal expansion of many of the gas pools in the region. This regional approach implies lateral connectivity of the gas pools which is

not supported by more detailed engineering data, such as pressure survey data. In fact, the areal expanse of some of the newly released EUB Pool Orders actually creates significant conflict with the EUB's own Decision 2003-023 in the Chard-Leismer Area, as gas which was approved for production in this decision is in fact categorized as associated gas by the RGS. In early December, new EUB Pool Orders issued for the study area suggested that the Board was recognizing additional vertical and lateral segregation within the previously identified pools, however, less than one month later, the EUB pool orders had changed drastically as approximately 90 percent of the pressure data was disregarded and said to be non-conclusive.

In December 2003, engineering data and interpretations were submitted to the EUB by PET that demonstrated that when detailed engineering analysis is completed, smaller pools are the resulting interpretation. This is definitely the case at Surmont where the industry has done extensive analysis with an increased volume of data. This underscores the need to integrate detailed engineering data with the regional geological interpretation to delineate gas pools in this region before any determination as to the productive status of wells is made. The cost to gas producers of recommendations which are not well researched is very high and very real.

4. What is Commercial Bitumen?

There remains great uncertainty around what is commercial bitumen and what impact gas depletion has on the ultimate bitumen recovery. The RGS aimed to provide a geological interpretation of where the gas pools are in communication with underlying units that have the potential for an aggregate bitumen thickness in excess of 10m. This approach of simply aggregating bitumen pay thicknesses results in overstating the lateral and vertical extent and continuity of the potentially commercial bitumen resource. Case by case assessment is required to determine where in fact the potential value of specific incremental bitumen recovery is indeed greater to Albertans than that of the producing associated gas reserve.

The EUB defined potentially recoverable bitumen after the gas/bitumen inquiry in 1997 despite having minimal actual SAGD field operation information. Six years of data from pilot and commercial projects can provide valuable technical insight as to the ultimate potential of bitumen. Further, Industry does not agree with the Board's definition of commercial bitumen. It should be noted only 44% of the bitumen in the shut-in area is leased by industry, and only 0.5% of the region (35 square miles) has SAGD projects proposed to pursue development of the bitumen.

A process for the ongoing review of the definition of commercially recoverable bitumen using reasonably foreseeable technology should be initiated. This requires the commitment of the Department of Energy, the EUB and Industry – to date this commitment has not been made. In addition, well-by-well, pool-by-pool assessment is required.

5. Process and Timing

The EUB has dictated an unprecedented process and timetable surrounding this issue due, it says, to the perceived urgency of the risk posed by current gas production to ultimate bitumen recovery. The perceived urgency in this matter is in conflict with the facts that this matter has been before the EUB for seven years and that no bitumen lease owners have put forth either shut-in applications or objections to the exemptions filed by gas producers with respect to GB 2003-28. On January 26, 2004 the EUB staff will release recommendations to continue or vary gas production status of wells subject to GB 2003-28. Within four weeks of receipt of the EUB recommendations, gas producers wishing to challenge some or all of those recommendations must file their written evidence in support of the challenge. An expedited and limited "hearing"

would follow two weeks after that. The geological study covers many thousands of hectares, over 900 producing wells, and over 5,000 additional wells which provide technical information which should be considered. Historically the Board has taken months, sometimes years, to deal with a single application in the region. It will be virtually impossible for the EUB staff to integrate all relevant engineering, geological and other information with the RGS by January 26 and to then make reasoned recommendations as to the productive status of that many wells. It will be equally unworkable for industry to develop a case for any disputed recommendations in the two weeks that follow that. The EUB's process is denying gas producers a fair hearing and due process.

6. Implications for Albertans

This continues to be a very large problem. While gas producers shut-in approximately 95 MMcf/d in good faith in September 2003 pursuant to GB 2003-28, the RGS now identifies over 220 MMcf/d of gas as associated with bitumen. If all of that production is shut-in, gas producers will have been denied access to assets valued at more than \$1.5 billion.

We recognize the EUB's mandate is conservation. However, we also believe it is outside the scope of the EUB to determine the degree of conservation without complete knowledge of the range of cost/benefits to the people of Alberta. Rather, it is the role of the government to assess if Albertans should be willing to take more risk relating to long-term conservation in exchange for what will be saved or gained in short term revenue, jobs, investment etc. The cost versus potential benefit to Albertans of removing the risk varies from the high-grade bitumen to the low grade bitumen. The immediate cost of removing the risk to the lowest grade bitumen, which is not currently leased by industry and most likely won't be pursued for decades may significantly exceed the potential benefit.

The RGS is but one piece of the information required for a rigorous determination of what, if any, current gas production poses a threat to ultimate bitumen recovery. However, the EUB's fast-track process will not allow for the incorporation of all of the other relevant data or considerations.