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OIL SANDS INFORMATION BULLETIN 2017-03

Subject: Amendments to the Oil Sands Royalty Regulations and Related Regulations

This Information Bulletin is being issued to provide oil sands operators with a summary of recent changes to five royalty-related regulations. These amendments are necessary to implement the Royalty Review Advisory Panel's recommendations including: enhancing royalty processes for the oil sands, reviewing oil sands allowed costs, and reviewing the method used to value oil sands products disposed of in arm's length transactions.

The amendments were developed in consultation with oil sands industry associations and operators in 2016. They reflect the Panel's recommendations to not change the oil sands royalty rates, and therefore should not result in significant changes to royalty payable. Most of the amendments are effective January 1, 2017.

Highlights of these changes are summarized below, by regulation:

Mines and Minerals Administration Regulation – This regulation describes general administrative procedures relating to mineral royalty and tenure in Alberta.

The amendments provide authority for the Minister to publish royalty information for each oil sands Project, starting in 2017 in respect of the 2016 production year. These amendments also give the Minister the authority to publish royalty information for crude oil and natural gas wells benefiting from strategic royalty programs under the Modernized Royalty Framework.

Oil Sands Royalty Regulation, 2009 – This regulation specifies the rules regarding how operators apply for an oil sands royalty Project, report royalty-related information, and pay royalties to the Crown.

Operators applying for oil sands royalty Projects from February 15, 2017, and onwards should be aware the amendments:

- Require operators to submit a Class 3 Cost Estimate if in an application or amendment application the total costs of a new processing facility and modifications to an existing processing plant will cost $50 million or more.
- Extend the prior net cumulative balance period from the current three years to five years.
- Clarify the rules governing non-Project royalty wells (NPR), to complement the implementation of the Modernized Royalty Framework (MRF):

- NPR wells that have applied for MRF strategic program benefits will not be allowed to form part of an oil sands royalty Project.
- NPR wells that have received an MRF drilling and completion cost allowance may be allowed to form part of an oil sands royalty Project provided:
  - an oil sands royalty Project application has been submitted within 12 months beginning on the first day of the month in which the royalty share for that non-Project well is determined under the MRF;
  - an oil sands royalty Project approval or amendment approval is granted; and
  - royalty payable in respect of the time prior to the NPR well forming part of the Project has been recalculated as though the well's total revenue were equal to C*.
- Any oil sands royalty Project wells that are no longer in a Project due to Project revocation or termination will pay royalty as follows:
  - if the first well event was spud before January 1, 2017, pursuant to the *Petroleum Royalty Regulation, 2009* until December 26, 2026, and thereafter pursuant to the *Petroleum Royalty Regulation, 2017.*
  - if the first well event was spud date on or after January 1, 2017, pursuant to the *Petroleum Royalty Regulation, 2017* as though the well's total revenue was equal to C*.

- Provide how interest will be calculated after a dispute is resolved.
- Increase the period for Project operator's forecasts from 10 years to 15 years.
- Provide for the mandatory notification of suspension of Project operations, prior to such suspension.
- Provide for the use of the new USD/CAD daily exchange rate to be published by the Bank of Canada starting in March 2017, when the noon exchange rate becomes unavailable.
- Clarify the language relating to some definitions, determination of consideration for other net proceeds, and Project reporting.

Mines and Minerals Dispute Resolution Regulation – This regulation details the procedures for resolving disputes between the Crown and oil sands, and petroleum and natural gas, royalty operators.

The amendments:
- Eliminate Oil Sands Dispute Review Committees.
- Enable the Minister to make the final decisions on objections.
- Harmonize the dispute resolution process for oil sands and conventional oil and gas.

Operators with objections for which a proposed resolution has been issued prior to February 15, 2017 will not be affected by these changes. Those objections will continue to be resolved under the former process.

Oil Sands Allowed Cost (Ministerial) Regulation – This regulation specifies the costs eligible for royalty calculation purposes, and the procedures for determining cost of service calculations. The Royalty Review Advisory Panel recommended that Alberta Energy "review allowable costs in the oil sands" in consultation with the oil sands industry.

Project operators should be aware of the following amendments:

- The cost schedules allow certain intervener costs incurred by an operator in respect of an application to the Alberta Energy Regulator.
- The costs schedules provide a broader ability to allocate costs for certain employees dedicated to one or more oil sands royalty Projects.
- The cost schedules disallow the following:
  - Costs of captive insurance premiums paid to affiliated insurance companies.
  - Costs for acquisition of land (real property).
  - Recruiting and advertising costs.
  - All costs related to employee gifts and awards.
  - Any cost related to hosting and entertainment.
- Clarifications to the cost of service calculation methodology to recognize capital costs incurred to complete a capital asset, which costs otherwise might not be recognized given the timing rules for the determination of the cumulative capital cost of that capital asset.

In addition, a new, reorganized Schedule 1.1 has been added to list allowed costs incurred on and after January 1, 2017. Schedule 1 remains in place for costs incurred before January 1, 2017.

Bitumen Valuation Methodology (Ministerial) Regulation – This regulation details the rules and procedures for the bitumen valuation methodology used to price bitumen from oil sands royalty Projects that is disposed of or transferred to affiliated or related parties.

Project operators should be aware of the following changes to the regulation:

- Modifications to the floor price formula. The floor price now includes a deduction based on the differential between Brent and West Texas Intermediate.
- Until the end of December 2019, an additional quality adjustment of $4.34171 per cubic metre.
- The introduction of new rules to clarify the treatment of tankage and terminalling costs in the transportation allowance.

The BVM components published in February 2017 for January 2017 reporting will reflect the new rules. Operators can access the BVM components report and the updated BVM model calculator at http://www.energy.gov.ab.ca/OilSands/1542.asp .

The amended *Mines and Minerals Administration Regulation*, *Oil Sands Allowed Costs (Ministerial) Regulation*, *Oil Sands Royalty Regulation, 2009* and *Bitumen Valuation Methodology (Ministerial) Regulation* will be published online to the Alberta Queen's Printer website shortly. The address for the Queen's Printer is http://www.qp.alberta.ca/.

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