# Oil Sands Royalty Business Training Acts & Regulations Overview

Prepared by Alberta Energy for
Oil Sands Royalty Business Training
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# Topics we will discuss

- 2021 changes to regulations
- *Mines and Minerals Act*
- *Mines and Mineral Administration Regulation*
- *Oil Sands Royalty Regulation, 2009*
- *Oil Sands Allowed Costs (Ministerial) Regulation*
- *Mines and Minerals Dispute Resolution Regulation*
- *Bitumen Valuation Methodology (Ministerial) Regulation*
- *Oil Sands Tenure Regulation, 2020*

The legislation can be found online at:

- Alberta Energy website: https://www.alberta.ca/oil-sands-acts-and-regulations.aspx
- Alberta Queen's Printer website : http://www.qp.alberta.ca/Laws_Online.cfm
- The Canadian Legal Information Institute website: http://www.canlii.org/en/index.html

# Alberta Energy also publishes

- Oil Sands Royalty Guidelines
  https://open.alberta.ca/publications/alberta-oil-sands-royalty-guidelines-principles-and-procedures-2018

- Oil Sands Tenure Guidelines
  https://open.alberta.ca/publications/alberta-oil-sands-tenure-guidelines-principles-and-procedures-2020

- Information Bulletins/Information Letters
  https://www.alberta.ca/oil-sands-information-bulletins-and-letters.aspx

**The guidelines are not authoritative.**
**They do contain helpful commentary and examples.**

# Quick Reminders

- Acts/regulations change.

- They come into force, can be amended, can expire or can be repealed.

- Legislation can come into force
  - on proclamation;
  - on a named future date; or
  - on a previous date (retroactive).

# 2021 Royalty Regulation-Related Changes

- Administrative items, focused on clarifying the eligibility of certain costs.
- The ability to apply for primary projects in the oil sands royalty regime.
- The extension of the Bitumen Valuation Methodology Quality Adjustment.

# *Oil Sands Tenure Regulation, 2020*

# *Oil Sands Tenure Regulation, 2020*

- Oil sands tenure: the system by which the Crown provides an agreement for Crown oil sands rights for a certain period and with certain conditions.

- Crown-owned oil sands rights are disposed by means of leasehold agreements:
  - Primary lease - issued for an initial term of 15 years; or
  - Continued lease - issued upon application of the leaseholder prior to expiry of primary lease term for continuation of that lease, continuing it on an indefinite basis.

- Conditions to be granted continuation include payment of royalties on leased substance, payment of annual rent, and compliance with all relevant legislation.

# *Oil Sands Tenure Regulation, 2020*

- A continued lease is a primary lease that has completed its primary term and has been continued. It may be continued in:
  - producing status; or
  - non-producing status.

- Non-producing continued leases are subject to the payment of escalating rent.

- As of the date of this presentation, production at a rate of 2,400 m3 per section, averaged across a given lease, over a term year is required for producing status.  This is subject to change at any time.

- Tenure and royalty:
  - The costs of acquiring a lease (Crown bonus or payments to third parties) are not allowed costs.
  - Escalating rental payments are not allowed costs.
  - Annual rent for lease is an allowed cost.

# *Mines and Minerals Act*

# *Mines and Minerals Act* (MMA)

- Passed by the Legislature.

- There are many regulations enacted under the MMA.
  - Regulations (i.e., OSRR'09, MMAR) are enacted by the Lieutenant Governor in Council (Cabinet).
  - Ministerial Regulations (i.e. OSACR, BVMR) are enacted by the Minister, reviewed by the Cabinet.

# *Mines and Minerals Act*

- The MMA asserts the Crown's right to royalty, and provides for the determination of royalty rates:

- s. 34 (1) The royalty reserved to the Crown in right of Alberta on a mineral recovered pursuant to an agreement shall be the royalty prescribed from time to time by the Lieutenant Governor in Council.

# *Mines and Minerals Act*

Other relevant provisions to ongoing royalty reporting:

- s. 37 – to deal with “artificial or undue” reduction of royalty.
- s. 38 – recalculation of royalty (audit).
- s. 39 – ability to object to royalty calculation.
- s. 47 – requirement to keep records.
- s. 48 – to deal with disclosure (return of information).
- s. 50 – non-disclosure of royalty filings (FOIP override).
  - ➢ There are exceptions in certain situations.
- s. 91.1 – obligations to run with agreements.



Classification: Protected A

# *Mines and Minerals Administration Regulation*

- Deals with the administration of the MMA

Relevant provisions:

- s. 4 – giving notices.
- s. 23 – application of payment.
- s. 25 – record retention.
- s. 26 – disclosure of oil sands project information.

## *Oil Sands Royalty Regulation, 2009*

# *Oil Sands Royalty Regulation, 2009*

History

- 1967- 1997: Each project negotiated its own royalty arrangement – Crown Agreements.
- The reasoning behind this at the time was:
  - Each project was treated as unique.
  - There were not enough projects to justify the development of a generic oil sands royalty regime.
  - Government lacked in experience and knowledge regarding the oil sands business and market.
- 1993: Joint industry-government National Task Force on Oil Sands Strategies was launched and published its report in 1995.

# *Oil Sands Royalty Regulation, 2009*

History

- The key recommendation of the 1993 Task Force was that a single, generic royalty regime should be established through legislation:
  - All new projects on a level playing field.
  - Fiscal certainty and stability.
  - Encourage oil sands investment.
- This led to the development of the *Oil Sands Royalty Regulation, 1997*.
- Prior to 2009, some principles of the generic oil sands royalty regime (i.e., royalty rates and return allowance) were written into the MMA.
  - This is no longer the case: all the core royalty provisions related to oil sands are now found in the regulations.

# *Oil Sands Royalty Regulation, 2009*

History

- The OSRR'97 generic regime was modified on January 1, 2009 – the *Oil Sands Royalty Regulation, 2009* became effective.

- At that time, cost rules and bitumen valuation rules were removed from the OSRR regulation, and the separate *Oil Sands Allowed Costs (Ministerial) Regulation* and *Bitumen Valuation Methodology (Ministerial) Regulation* were created.

# *Oil Sands Royalty Regulation, 2009*

- The OSRR'09 is the key piece of legislation in the generic oil sands royalty system.
- It sets out:
  - How to apply for an oil sands royalty project, or a project expansion.
  - How royalty is calculated and paid.
  - The reporting requirements for oil sands operators, and
  - The penalties and interest that may arise.
- The OSRR'09 was amended in 2017 to reflect recommendations of the royalty review panel.
  - It was most recently amended in 2021.

# *Oil Sands Royalty Regulation, 2009*

Basic Information

- You need an oil sands agreement to produce oil sands.
- Producing oil sands alone does not entitle you to the revenue minus cost (R-C) royalty terms of the OSRR'09.

# *Oil Sands Royalty Regulation, 2009*

Without an oil sands royalty project approval:

- Royalty share is determined according to conventional oil royalty regulations.
- A cash payment of that amount is made in respect of royalty.

For a non-project oil sands mine:

- Royalty is 20% of volumes, paid in cash, based on the par price for oil sands prescribed for the month.

# *Oil Sands Royalty Regulation, 2009*

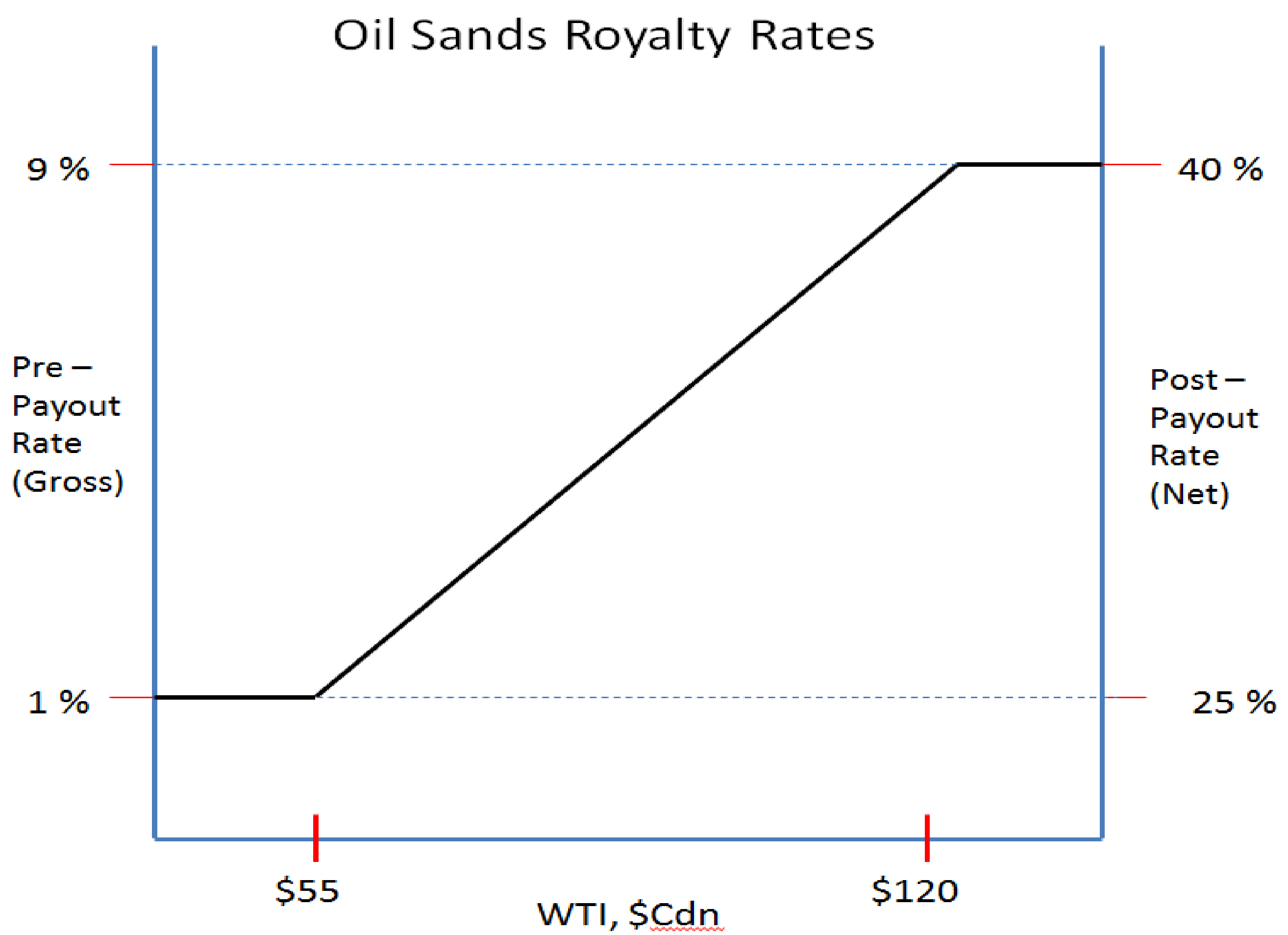
Philosophy behind royalty regime:

- Oil sands royalty policy has always recognized the higher initial capital investments and the higher operating costs associated with oil sands production.

Royalty design has reflected these factors through:

- A lower initial royalty rate, based on a project's gross revenue.
- An increased royalty rate once the project has recovered its costs and a specified rate of return.

# *Oil Sands Royalty Regulation, 2009*



# *Oil Sands Royalty Regulation, 2009*

**Distinction:**

**Royalty rate versus Crown royalty share**

# Royalty rate versus Crown royalty share

Total Volume Produced/Crossing RCP

Crown's Royalty Share

(Crown's actual volume)

Royalty Compensation

(Money paid to Crown for Crown Volumes)

# *Oil Sands Royalty Regulation, 2009*

- Where does the royalty determination and subsequent transfer happen?

- At the project's royalty calculation point.

  - In general, the Royalty Calculation Point is the first point of measurement where oil sands products are obtained from the project prior to disposition or prior to the product being removed from project boundary.

  - If the product is raw bitumen and goes to a cleaning or cleaning/blending facility off the project land before sale, then Royalty Calculation Point is at the outlet of that facility.

# *Oil Sands Royalty Regulation, 2009*

- At the Royalty Calculation Point:
  - Volume is measured at Royalty Calculation Point.
  - Crown physical share is determined.
  - Oil sands products are valued (unit price).
  - Crown share of oil sands products are transferred to the lessee(s).
  - Project, Gross and Net Revenues are determined.
  - Royalty compensation is calculated.
  - Crown Royalty in cash is due.

# *Oil Sands Royalty Regulation, 2009*
# Key Concepts

Please note: some of these items are covered in greater detail in later presentations

- Unit Price is the price used for each oil sands product, to calculate the value of the Crown's royalty share of that product, at the point it is transferred to the lessee's share, immediately downstream of the RCP.

$$\text{Unit Price} = \frac{\text{Total Consideration (TC)} - \text{Handling Charges (HC)}}{\text{Total Disposition (TD)}}$$

- Project Revenue (PR) for a month or a Period is the sum of all quantities of oil sands products (delivered from a project's development area and measured at their respective RCPs) multiplied by their respective unit prices

$$\text{Project Revenue} = \sum (\text{Product Volume} * \text{Unit Price})$$

# *Oil Sands Royalty Regulation, 2009*
# Key Concepts

- Gross Revenue (GR) for a project for a month or a Period means its project revenue less the cost of diluent contained in any blended bitumen at the RCP included in the calculation of its project revenue.

  Gross Revenue = Project Revenue – Cost of Diluent

- Net Revenue (NR) is the amount by which project revenue exceeds allowed costs of the project less other net proceeds in a period.

  Net Revenue = Project Revenue – (Allowed Cost – ONP)

  – Note 1: In the calculation of the net revenue, the cost of diluent purchased in the period is an allowed cost.
  – Note 2: Other Net Proceeds (ONP) refers to any revenue generated in a period from the sale, lease or license of any non-oil sands product.

# *Oil Sands Royalty Regulation, 2009*
# Key Concepts

- Pre-payout refers to the period of a project when:

  Cumulative Costs – Cumulative Revenues > 0
- During pre-payout, royalty is paid at

  Pre pay-out gross revenue royalty rate (RG %) * Gross Revenue

- Post-payout refers to the period of a project

  when Cumulative Costs – Cumulative Revenues ≤ 0
- During post-payout, royalty compensation payable by the project is the greater of
  - Post pay-out gross revenue royalty rate (RG %) * Gross Revenue and
  - Net Royalty Percentage Factor * Net Revenue.

**Note:** Department of Energy publishes the pre-payout/post-payout gross revenue royalty rate RG% and net royalty percentage factor for each month in an Information Letter published on the Department's website.

# Royalty calculation in simple terms

- Pre-payout, blended bitumen product where:
  - the unit price >zero, and
  - the value of the blended bitumen (if any) containing the Crown's share of clean crude bitumen is greater than the cost of the diluent in that volume of blended bitumen.
- The royalty compensation payable by the project can be simply calculated as: RG % x Gross Revenue
  - Where Gross Revenue = Project Revenue – Cost of Diluent

- Post-payout, blended bitumen product: where, in a Period, for a post-payout project:
  - the unit price >zero, and
  - the value of the blended bitumen (if any) containing the Crown's share of clean crude bitumen is greater than the cost of the diluent in that volume of blended bitumen, then:
- The royalty compensation payable by the project is simply the greater of:
- RG % x Gross Revenue, and
- NRPF x Net Revenue
  - Where Gross Revenue = Project Revenue – Cost of Diluent,
  - Net Revenue = Project Revenue – (Allowed Costs – Other Net Proceeds)

**NOTE: This will be dealt with in detail in a later presentation**

# Assets included in project

- If assets are included in a project, the eligible costs of those assets are allowed costs.
- Requires operators to submit a Class 3 Cost Estimate if, in an application or amendment application, the total costs of a new processing facility or modifications to an existing facility will cost $50 million or more.
- Generally speaking, an asset is either all in or all out of a project.  An asset can be included in a project if it meets the project use threshold (75% for a single project, or almost exclusively for more than one or more affiliated projects).

- There are some exceptions where a portion of an asset can be included in a project.  They are specified in s. 14 of the OSRR’09.
  - Examples:  Processing plants, cogeneration units, cross-boundary wells, systems listed in s. 14(14).

# OSRR'09, s. 15

What is prior net cumulative balance (PNCB)?

- Costs (and other net proceeds) incurred during the five years prior to a project's effective date.
- Royalty proceeds or payments to the Crown.

Key points:

- PNCB is determined at the discretion of the Minister; generally if a cost doesn't meet the criteria for an allowed cost, it won't meet the criteria for a PNCB cost.
- Costs that should be claimed as PNCB costs cannot be claimed as project costs.

# OSRR'09, s. 23

What are other net proceeds (ONP)?

- Proceeds from the sale, lease, license, or other disposition or use of project assets for non-project purposes.
- Proceeds from litigation, refund of deposits, or custom processing.

- ONP are not project revenues: they are reductions to allowed costs.

  Net Revenue = Project Revenue – (Allowed Cost – ONP)

- ONP can't make costs in a Period negative; any excess is carried forward.

# When is royalty easy?

- When all transactions are arm’s length
- With no non-third party affiliate costs or revenues, the project interest aligns with the Crown’s royalty interest.
- The Crown needs to ensure that costs and revenues are accurately reported.

# When is royalty difficult?

- When arm's length transaction is less than 40% of the total volume at RCP for an oil sands product.

- When the royalty project sits within a larger corporate structure (integrated producers), we need to consider non-arm's length (NAL) costs attributed to the project.

- The Crown needs to ensure NAL costs are (1) incurred for the project and (2) correctly valued.

# How do we deal with these complexities?

- OSAC regulation.
- BVM regulation.
- These regulations were developed, in large part, to cope with the complexities that arise from non-arm's length transactions.

# *Oil Sands Allowed Costs (Ministerial) Regulation*

# *Oil Sands Allowed Costs (Ministerial) Regulation*

Deals with three key issues:

- What costs are allowed for royalty calculation purposes?
- How can costs be allocated to royalty projects?
- How are non-arm's length costs to be valued?

# *Oil Sands Allowed Costs (Ministerial) Regulation*

What costs are allowed costs?

Allowed costs must be:

- Incurred by or on behalf of the lessees or operator;
- Incurred for project operations;
- Reasonable under the circumstances in which they are incurred;
- Adequately evidenced, to the satisfaction of the Minister.

# *Oil Sands Allowed Costs (Ministerial) Regulation*

Types of allowed costs:

Allowed costs must be one of:

- Fundamental costs
  - To recover, obtain, process, transport or market oil sands or oil sand products.
  - To reclaim or to abandon project lands.
  - To comply with environmental laws.
  - NOT specifically excluded.
  - NOT corporate overhead.
- Specifically included costs under Schedule 1.1 for costs incurred following Jan 1, 2017. Earlier costs must be specifically included under Schedule 1.
- Discretionary allowed costs, on application, at the Minister's discretion.

# *Oil Sands Allowed Costs (Ministerial) Regulation*

Allocating Allowed Costs

- If a cost is incurred that is only in part for an oil sands royalty project, a portion of the cost must be allocated to the project.

- Cost allocation is covered in s. 8 of the OSACR, as well as in Schedules 2 and 3.

- Where the Regulation prescribes a cost allocation methodology, that method must be followed unless the operator applies for, and the Minister approves, an alternate methodology.

# *Oil Sands Allowed Costs (Ministerial) Regulation*

## Arm’s Length & Non-Arm’s Length Costs

- What is a non-arm’s length transaction? (s. 2, OSRR'09)
  - A self-dealing transaction.
  - A transaction with an affiliate.
  - A transaction involving compulsion.
  - A transaction where the consideration is linked to other obligations.
  - A transaction determined by the Minister to be non-arm’s length.
- An arm’s-length transaction is one that is:
  - not non-arm’s length, or
  - determined to be arm’s length by the Minister.

# *Oil Sands Allowed Costs (Ministerial) Regulation*

Cost of Service – COS

- Cost of service means the actual costs of providing a service. The following are calculated according to the Minister’s directions:
  - the depreciation charge of the capital assets used to provide the service, and
  - the rate of return on the undepreciated value of those assets.

COS Rules:

- ss.12.1 – 12.7 in OSACR.
- Straight-line depreciation.
- Rate of return is the long-term bond rate (LTBR).

# *Oil Sands Allowed Costs (Ministerial) Regulation*

If in doubt, ask!

- If you are not certain about the AL/NAL status of any of the transactions related to your project, contact Alberta Energy for a ruling or an interpretation.

# *Mines and Minerals Dispute Resolution Regulation*

# *Mines and Minerals Dispute Resolution Regulation*

Appeal and Dispute

- MMA, s. 38 (2)
  - The Minister may calculate, recalculate or make additional calculations on: 1) Crown's royalty share, 2) royalty proceeds, and 3) interest or penalty.
  - Operators can make amendments within three years after the end of the calendar year.
  - Minister must conduct the audit within five years after the end of the calendar year.
  - If a calculation is respect of a prescribed matter is determined, the Minister must complete no later than five years and six months.

- MMA, s. 39 (1)
  - Oil sands project owners generally have the right to object to calculations or recalculations of the Minister.

# *Mines and Minerals Dispute Resolution Regulation*

Appeal and Dispute

- When an operator disputes a royalty assessment, they may apply in writing to the Director of Dispute Resolution.
- MMDRR, ss. 2 (1) and 2 (4)
  - An applicant may make an objection related to a prescribed matter referenced in a prescribed matter Regulation in accordance with this Regulation.
  - An objection must be made in writing to the Minister only after the applicant has contacted the Department for the purpose of resolving the matter in dispute.

# *Bitumen Valuation Methodology (Ministerial) Regulation*

# *Bitumen Valuation Methodology (Ministerial) Regulation*

- BVM is mainly triggered by integrated projects.
- BVMR prescribes the methodology used to value an oil sands project's bitumen for royalty purposes when the project has insufficient arm's-length (AL) sales.
- Insufficient AL sales are determined by comparing the volume of AL sales and the volume of product delivered at the Royalty Calculation Point (RCP).

# *Bitumen Valuation Methodology (Ministerial) Regulation*

Who Needs to Use BVM?

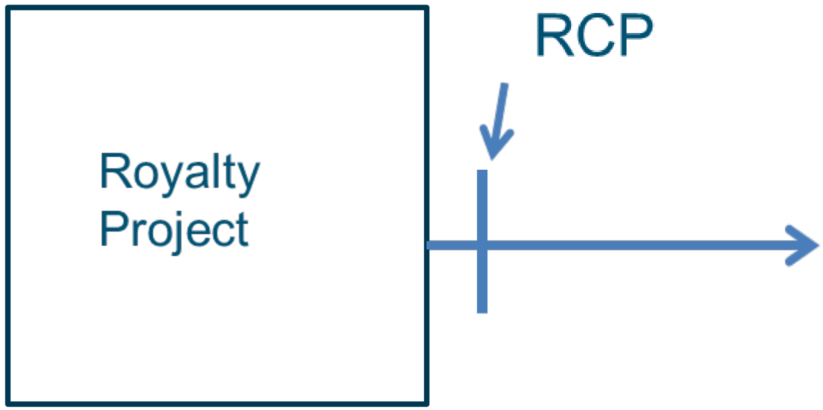
- 40% is the Third Party Disposition Threshold in a royalty period (monthly for pre-payout, and annual for post-payout).

- If the volume of AL sales is ≥ than 40% of the RCP volume, BVM is not needed.
  - The unit price calculated from the arm's-length sales can value all RCP volumes.

- If the volume of AL sales is < 40% of the RCP volume, a project needs BVM.
  - The unit price calculated from a weighted average can value all RCP volumes.

# Example:

## Volume at RCP = 100 m3




Sales:

AL = 35

Remaining Volume = 65

AL Sales/ RCP volume = 35% < 40%: BVM needed.

- 35 volumes at RCP will be valued at the AL unit price.
- 65 volumes at RCP will be valued by BVM.
- The Project unit price will be a weighted average of the AL and BVM prices.

***NOTE: This will be dealt with in detail in a later presentation**

# *Bitumen Valuation Methodology (Ministerial) Regulation*

The weighted-average formula [s. 32 (4), OSRR'09]

Unit Price of the Blend

$$= \frac{\text{(AL Sales + Remaining)}}{\text{PQ}} = \frac{\text{(TC-HC)} + [(\text{NQxP}) + \text{CD}]}{\text{PQ}}$$

Where:

- TC - HC = total consideration less handling charges for AL blend dispositions;
- NQ = bitumen volumes in the NAL blend;
- P = the BVM bitumen price;
- CD = cost of diluent in the NAL blend;
- PQ = the RCP blend volume.

**NOTE: This will be dealt with in detail in a later presentation**

# *Bitumen Valuation Methodology (Ministerial) Regulation*

How is the BVM price determined?

In two steps:

- The project's bitumen is valued at Hardisty, minus quality adjustment of 0.69/bbl; and

- A transportation allowance is applied to get the bitumen value at the project's RCP.

# *Bitumen Valuation Methodology (Ministerial) Regulation*

- The Hardisty Bitumen Price

  – The Hardisty bitumen price for a project is calculated in each month as the greater of the floor price and the price determined by the BVM model.

- The floor price in each month is the greater of:
  – The average price per m3 of Mexican Maya crude for the month, minus C$250 minus the greater of $0 per m3 and (BRENT – WTI); and
  – C$10/m3.

# *Bitumen Valuation Methodology (Ministerial) Regulation*

The BVM Hypothetical Model

- The methodology we use to value a project's bitumen at Hardisty is as follows:
  - Alberta Energy assumes that bitumen is blended with a standard diluent at the project and sold into the WCS pool at WCS Hardisty prices.
  - The density blending model is used to back out the bitumen price.

**Project Bitumen** + **Standard Diluent (CRW)** = **WCS**

- In practice, just enter the bitumen density in Alberta Energy's on-line calculator.

## Alberta Oil Sands
## Bitumen Valuation Methodology

$4.34171 << *Quality Adjustment, \$Cdn/m³*

12 << *( Bitumen_Synbit) - (Bitumen_Dilbit) Density Blending Difference, kg/m³*

| 2022 | Six-measurement [5,6] Rolling Average Bitumen Density kg/m³ @ 15°C | F/X $Cdn/$US | WCS [1] Settlement Price $US/bbl | WCS [2,3] Dilbit Volume Fraction | WCS [2,3] Bitumen Synbit Premium $US/bbl | WCS [2] Blend Density kg/m³ @ 15°C | Condensate [4] "CRW" Allowance Price $Cdn/m³ | Condensate [4] "CRW" Density kg/m³ @ 15°C | *Royalty Value* *Bitumen @ Hardisty* $Cdn/m³ | *Royalty Value* *Bitumen @ Hardisty* $US/bbl |
|---|---|---|---|---|---|---|---|---|---|---|
| Jan | 1015.0 | 1.26160 | 65.60 | 1.00 | 1.57 | 922.6 | 666.66 | 741.0 | 434.10 | 54.68 |
| Feb | 1015.0 | 1.27160 | 79.10 | 1.00 | 1.55 | 921.7 | 751.07 | 745.0 | 558.32 | 69.78 |
| Mar | 1015.0 | 1.26580 | 94.57 | 1.00 | 1.52 | 921.8 | 877.98 | 741.5 | 675.41 | 84.80 |
| Apr | 1015.0 | | | | | | | | #N/A | #N/A |
| May | 1015.0 | | | | | | | | #N/A | #N/A |
| Jun | 1015.0 | | | | | | | | #N/A | #N/A |
| Jul | 1015.0 | | | | | | | | #N/A | #N/A |
| Aug | 1015.0 | | | | | | | | #N/A | #N/A |
| Sep | 1015.0 | | | | | | | | #N/A | #N/A |
| Oct | 1015.0 | | | | | | | | #N/A | #N/A |
| Nov | 1015.0 | | | | | | | | #N/A | #N/A |
| Dec | 1015.0 | | | | | | | | #N/A | #N/A |

# *Bitumen Valuation Methodology (Ministerial) Regulation*

- The Transportation Allowance (TA)
  - “Nets back” the Hardisty Bitumen Price to the project RCP:
    - the shipment of the hypothetical blend volume from the project to Edmonton/Hardisty, and
    - the shipment of the hypothetical diluent volume to the project.
- TA is based on the tariffs of existing pipelines.
- If you have no pipeline connection (e.g. railing) for TA, one can be prescribed. Let us know.
- Unless undiluted bitumen is shipped on a heated line – there is no diluent allowance in that situation.

# Bitumen Valuation Methodology (Ministerial) Regulation

More complicated scenarios

- A project may be linked to Edmonton/Hardisty not by a single pipeline, but by a series of two or more pipelines.
- A project may have more than one potential pipeline route to access Edmonton/Hardisty.
- A project may have multiple oil sands products.

For these scenarios:

- Complex transportation scenarios may be reviewed closely by Alberta Energy.
- Upon application by a project operator, the Minister of Energy may in his/her discretion decide to prescribe a project-specific methodology or value for a transportation allowance.

# *Bitumen Valuation Methodology (Ministerial) Regulation*

Some final thoughts on BVM:

- The valuation of a project's bitumen at Hardisty is a straightforward calculation, but accurate density measurement of project bitumen is crucial.  If BVM is required, accurate density measurement satisfactory to the Department is necessary.

- For the Transportation Allowance: Once the correct removal pipeline and its tariff have been identified, it should be fairly easy to apply on an ongoing basis.

- If you believe that the BVM transportation allowance calculation cannot be applied to your project, (i.e., rail only), please contact Alberta Energy as soon as possible so that appropriate values can be provided in a timely fashion.

# Questions?