Alberta Court of Queen's Bench has interpreted Prior Net Cumulative Balance provisions of the Oil Sands Royalty Regulation in Fort Hills Energy Corporation v Alberta (Minister of Energy), 2018 ABQB 905

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Summary

In *Fort Hills Energy Corporation v Alberta (Minister of Energy)*, 2018 ABQB 905 ("*Fort Hills*"), the Alberta Court of Queen's Bench reviewed Alberta Department of Energy's ("Alberta Energy") decision which rejected Fort Hills Energy Corporation's PNCB claim of approximately $1.9 billion for the Fort Hills Oil Sands Project (the "FHOSP"). Of particular importance are the Court's consideration of costs incurred for subsequent amendments of the project's scheme approval, how this decision fits with the 2017 amendments to the *Oil Sands Royalty Regulation,* 2009 (AR 223/2008) ("OSRR"), and the Court's interpretation of "substantially suspended."

Background

To accelerate the development of the oil sands, the Government of Alberta adopted a generic royalty regime in 1997 whereby the Crown shared the risk of development by taking a minimum royalty until an oil sands project reached a point where cumulative revenues equalled cumulative costs (the "Payout"). The regime operates on the principle of revenue minus allowable cost. The legislative and policy framework for Oil sands Royalty Project Approval include, among others, the OSRR and its predecessor, the *Oil Sands Allowed Costs (Ministerial) Regulation* (AR 231/2008) ("OSAC"), and the Alberta Oil Sands Royalty Guidelines: Principles and Procedures. The regime applies to oil sands developers who, upon application, had their Projects approved under the Regulations ("Oil Sands Royalty Projects"). The project's Prior Net Cumulative Balance ("PNCB") and costs allowable thereunder are determined in the application process. Many issues arise such as the cost of assets that support the project but located outside the project lands, period within which costs were incurred, and whether the project was substantially suspended or abandoned in any relevant period. The Oil Sands Dispute Resolution Committee ("OSDRC") considers disputes concerning allowed costs

between oil sands producers and the Alberta government, but not disputes involving PNCB.

The FHOSP project scheme was first approved under the Oil Sands Conservation Act (the "Act") in 2002 (the "Approval"). The Operator sought and obtained amendments of the Approval in 2005 and 2007. In 2008 oil prices dropped and the pace of the FHOSP was slowed between 2009 and 2010. The decision as to whether to complete the FHOSP was also extended. In 2011 the Operator submitted an OSRR Project application to Alberta Energy for an effective date of November 1, 2011 (the "Effective Date") and a PNCB of $1,898,205,145 over the five years prior to the Effective Date. In 2012, a Ministerial Order approved the PNCB to be $33,024,321 subject to audit, and conditional on the FHOSP commencing production by January 1, 2016.

Alberta Energy later conducted an audit of the PNCB which resulted in a 2015 decision that the PNCB was Nil. Alberta Energy concluded that the Operator was not pursuing regulatory approval for the FHOSP during the fourth and fifth year prior to the Effective Date, and that the FHOSP was substantially suspended during the three years immediately prior to the Effective Date. Alberta Energy categorized the costs in section 15 of the OSRR by the period during which they were incurred in relation to the project's effective date. The reason was that the farther away from the effective date the costs were incurred, the greater the restrictions for their inclusion in the PNCB determination, in order to encourage the expeditious development of oil sands projects.

Issues

The issues before the Court were whether: (a) Alberta Energy's exclusion of all FHOSP costs incurred in the 4th and 5th years preceding the Effective Date (i.e. November 2006 to November 2008), in the total amount of $859,267,048 (the "4th/5th Year Costs"); and (b) Alberta Energy's exclusion of $791,831,844 of FHOSP costs incurred in the 3-year period preceding the Effective Date (i.e. November 2008 to October 31, 2011) (the "3 Year Costs").

Decision

The parties agreed that the standard of review was reasonableness. Justice Yamauchi found Alberta Energy's decision on the 4th/5th Year Costs reasonable, but found the decision on the 3 Year Costs unreasonable. Interpreting section 15 of the OSRR, the Court held that the Minister has considerable discretion when determining the PNCB, which discretion must be exercised within the legislative framework. Given that no court in Alberta had considered the policy, object, and purpose of the OSRR, the Court held that the rationale for these provisions are to ensure that: (a) a developer is entitled to recover its costs of developing an oil sands project before it is required to pay an enhanced royalty to the Crown; (b) developers are encouraged to develop the oil sands project in a timely manner; and (c) the Crown is not required to bear costs that do not advance the oil sands project.

The 4th/5th Year Costs

With respect to the 4th/5th Year Costs, pursuant to the OSRR an operator is entitled to claim these costs if it was diligently pursuing the approval of the project at the time the costs were incurred. Thus, the question was whether the Operator was diligently

pursuing regulatory approval under the Act at that time, given that the Approval for FHOSP was issued in 2002 prior to the time the claimed costs were incurred. Alberta Energy argued that section 15(2)(b) OSRR did not apply to subsequent regulatory approval or amendment of any approval of the project. The Operator argued that the approval contemplated in the OSRR was not limited to the first or original 2002 Approval. Justice Yamauchi held that while he might not agree with how the Minister interpreted the criteria in section 15(2)(b) OSRR, Alberta Energy's interpretation was one of several reasonable interpretations of the section. The 4th/5th Year Costs were not eligible for inclusion in the PNCB. Accordingly, Alberta Energy's decision dismissing the Operator's PNCB claim of approximately $860 million for the4th and 5th years preceding the Effective Date, was upheld.

The 3 year Costs

With respect to the 3 Year Costs, pursuant to section 15(3)(a) OSRR costs will be excluded in determining the PNCB if a project's development was substantially suspended or abandoned. Thus, the question was whether Alberta Energy was reasonable in its conclusion that the FHOSP was substantially suspended during this period. The Court noted that neither "substantially suspended" nor "abandoned" is defined in either OSRR or the OSAC.

The Court found that "Development" includes not just construction, but also the panoply of steps that the developer must take to begin production such as economic evaluation, funding, design, integration of new technologies, and satisfying regulatory requirements. While the Court agreed that it is not appropriate to take into account the reason for the "substantial suspension" of development of the project, the Court held that the Minister must examine contextually the situation before it, such that the surrounding circumstances must be considered to arrive at a principled decision. In other words, the Minister must consider the reason when conducting a contextual analysis.

The Court found that Alberta Energy failed to take into account two critical factors relevant to this period: the collapse of oil prices in 2008, and the Suncor Petro-Canada merger. Alberta Energy also ignored the hundreds of millions the Operator spent on the FHOSP including during this period. The Court also took into account that the Operator was undertaking work in respect of the FHOS Project during that period and all the steps taken by the Operator which were inconsistent with the Operator suspending the Project's development as set out in the OSRR. The Court disagreed with Alberta Energy's conclusion that the various components of the FHOSP that were shut down, cancelled, terminated, put on hold, or decision extended established that the project was "substantially suspended" under the OSRR. The Court concluded that Alberta Energy's finding that the FHOS Project was substantially suspended until the Effective Date was unreasonable. The Court further reasoned that it was inconsistent for Alberta Energy to argue that the FHOS Project was substantially suspended up to Effective Date, and also properly approved as an economically viable project under sections 11(1)(e) and 7(2)(f) OSRR. Collectively, these provisions indicate that a substantially suspended project is not suitable for inclusion in Alberta's royalty regime because it is not economically viable. The Court noted that while there might have been short periods during which the FHOSP was "suspended", Alberta Energy did not identify those particular times or whether those suspensions were "substantial." Accordingly, the Court quashed the decision as it relates to the 3 Year Costs and remitted the matter back to

the Minister to properly determine the FHOSP's PNCB in accordance with OSRR '09 s 15(2)(a) and the Court's directions.

Implications

This case set out, for the first time, the legal objectives of the OSRR and interpreted some undefined terms in the PNCB provisions. For OSRR oil sands projects, the decision is significant with respect to costs incurred for subsequent regulatory approval or amendment of a regulatory approval pursuant to the Act after the initial regulatory approval of the scheme. These costs may not be allowed in determining PNCB. However, there was an amendment to the OSRR in February 2017 which appeared not to have been considered in this decision. The 3 years in subsection 15(2)(a) was removed and replaced with 5 years. Subsections 15(2) (b) and (c) were repealed and the rest of section 15 was amended to remove references to them. These amendments effectively removed the requirement to separately consider the 4th and 5th year period costs. With respect to amounts to be included in determining PNCB, the only current requirement is subsection 15(a) set out as "the costs of the Project or of the expansion, respectively, incurred during the period of 5 years preceding the effective date of the Project or expansion." It remains to be seen how the current amendment will be reconciled with the decision in this case.

A more far-reaching implication of this decision is that the Court recognized and considered economic realities as part of the surrounding circumstances that must be considered to arrive at a principled decision in interpreting the *OSRR*. The Court adopted an interpretation that included the perspective of the Operator in dealing with such economic realities.

BLG will continue to monitor these issues and provide updates.

By

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