

## 2. Oil Sands Royalty Projects

### 2.1 What Is an Oil Sands Royalty Project?

Under *section 10* of the *Oil Sands Conservation Act*, the Alberta Energy and Utilities Board (EUB) may grant an approval to a person\* to construct facilities for, or commence or continue, a scheme or operation for the recovery of oil sands or crude bitumen\*.

The EUB may also grant approvals for processing plants\* under *section 11* and industrial development permits under *section 12*.

These schemes or operations approved under *section 10* of the *Oil Sands Conservation Act* are often loosely referred to as oil sands “projects”, but the term project has a specific meaning under the Regulation:

#### Projects Defined

*Section 1(aa)* of the *Oil Sands Royalty Regulation, 1997* (AR 185/97), defines an **oil sands project** as “a scheme or operation for the recovery within Alberta of crude bitumen or any other oil sands product from oil sands, whether or not in conjunction with the further processing of the crude bitumen or other oil sands product, where the scheme or operation is approved in one or more subsisting approvals under *section 16*.”

A developer who wishes to pay royalty under the terms of the Regulation must apply to the Department. If the scheme or operation has been approved by the EUB, and if a project meets the requirements of the Regulation, it may be approved as an oil sands royalty (or OSR) project.

An OSR project approval is granted by Ministerial Order. The project approval order includes appendices and attachments that describe a project, specify its effective date and prior net cumulative balance\*, and detail all related terms and conditions.

Department of Energy approval is required for all **new OSR projects**, as well as for all **amendments** to currently approved projects. (see 2.1.1.2.1, "Examples of Project Amendments")

## A Note on Terminology

A **project description**\* included as part of a project approval order specifies the lands, leases, operations, facilities and infrastructure that are considered to be “part of a project” or “in a project.” In this way, it defines what revenues and costs are included in (or excluded from) the royalty calculation: only approved components are considered part of a project.

The approved project description for a new oil sands royalty project is called the **initial project description**. When a project is amended, the approved description is referred to as the **amended project description**.

*Details about the application and approval process are outlined in 3, “Applying for Generic Royalty Terms”.*

### 2.1.1 Types of OSR Projects

Oil sands royalty projects fall into one of the following categories:

- new projects
- amendments to approved oil sands royalty projects (including expansions and amalgamations)

#### 2.1.1.1 New Projects

Projects are considered new if royalty payment under the Regulation has not been previously approved. For example, oil sands operations that previously paid royalty under the *Oil Sands Royalty Regulation, 1984 (AR166/84)*, are considered new when an application for approval as an oil sands royalty project is made.

When a new oil sands royalty project is approved, an attachment (schedule A) to the Ministerial Order outlines the **initial project description**, which specifies (at minimum)

- the **lands and leases** that have been approved as part of the OSR project
- the **project operations**, including the recovery method and technology that have been approved, the product that will be produced and, in some cases, the approved production capacity
- approved project **facilities** (including the required EUB approval orders) and **capital assets** (see 2.3.8, "Facilities and Capital Assets")

#### 2.1.1.2 Project Amendments

Oil sands developers who wish to modify the terms of their project description in any substantial way must apply to the Department of Energy. If the application meets the requirements of the Regulation (under *sec 16(1)*); an amended project approval order may be issued. The approval order includes an amended project description.

Project amendment applications are required for

- **expansions**, which typically involve the addition of lands or facilities

- **amalgamations**, which combine two or more approved OSR projects into a single project unit for the purposes of royalty calculation
- other changes to a project description issued when the project or subsequent project amendments were approved

Project amendment applications are encouraged—but not required—when a project's operator\* is replaced or when changes are made to the working interest ownership. In these cases, the project operator\* must nonetheless notify the Department so that records and contact lists can be kept up to date.

### Consulting with the Department

Oil sands royalty project developers are encouraged to discuss **all proposed changes to their OSR project** with the Department to determine if a project amendment application is required or if what is proposed is consistent with the existing project approval order appendices, schedules and attachments.

#### 2.1.1.2.1 Examples of Project Amendments

The following situations are examples of triggers or situations that create a need for project amendment application to be made to the Department. This is not meant to be an exhaustive list of triggers, but it should reflect most situations that require a project amendment. Again, if an operator is uncertain whether a particular situation would require an application, the operator should contact the Department.

- adding or removing lands, surface areas, geologic strata or oil sands leases from a project description
- changing the facilities or infrastructure used by a project, resulting in a change to the royalty calculation point\* or product
- adding or removing facilities that change a project scope for revenues or costs or both (e.g., a cogen plant, asphalt plant), but excluding situations where existing facilities are used to change a project output mix
- adding or removing facilities or infrastructure that are off project lands (i.e., facilities or assets that are not located within a project area, and not usually described in the EUB scheme approvals); for example, offsite batteries, roads, power lines, disposal wells, etc.
- changing a non-qualifying joint venture to a qualifying joint venture or vice versa
- changing project operations from the existing project description that include but are not limited to new phases and different recovery and extraction methods
- changing a project description as set out in the existing project approval order appendices, schedule and attachments
- changes to the EUB scheme approval (see note, below)

**Note:** When does a change to facilities or operations trigger an OSR project amendment?

Changes related to project facilities or operations must be approved by the EUB. When an amendment to an EUB approval affects an oil sands royalty

project project's recovery technology or processing capacity, the operator must apply to amend the OSR project approval order as well.

If the amendment to an EUB approval is minor, an OSR project amendment may not be required. Examples of minor amendments include changes to the operator's name, original well spacing, land use or approval for in-fill drilling\*.

**Operators should contact the Department** to determine if an OSR project amendment is required in such cases.

## 2.2 OSR Project Requirements

Both new oil sands royalty projects and OSR project amendments must meet the following requirements.

### 2.2.1 EUB Approval

Oil Sands Royalty Regulation, 1997 (AR 185/97), section 17(1)(a)

For an oil sands operation to qualify for generic royalty treatment, as outlined in the Regulation, its production schemes, operations, processing plants, wells and facilities must all be approved by the Alberta Energy and Utilities Board, as required *under sections 10 to 15 of the Oil Sands Conservation Act*.

Schemes, operations and facilities that do not have EUB approval cannot be approved as part of an oil sands royalty project.

*EUB application(s) and approval(s) must be filed with the Department as part of the application for OSR project approval. The required EUB approvals must be in place before an oil sands royalty project can be approved.*

### 2.2.2 Exclusions

Any portion of the land, facilities or assets included in an EUB-approved scheme may be excluded from an oil sands royalty project description at the request of the applicant or at the discretion of the Minister.

#### Note

Some types of capital assets used in an oil sands royalty project may require approval by agencies other than the EUB. It is the responsibility of a project operator to ensure that all necessary approvals are obtained.

### 2.2.3 Minimum Considerations

Oil Sands Royalty Regulation, 1997 (AR 185/97), section 17(3)

The Minister must, before issuing an oil sands project approval order (or amendment), consider, without limitation:

- Whether all project-related assets and operations are under **common management**.

- Whether all project components comply with the **location requirements** specified in the Regulation.
- Whether the project and all its components are **economically justifiable** and function as an integrated **economic unit**.
- The project's **impact to the royalty** payable to the Crown.

*In issuing a project approval order, the Minister may take additional considerations into account, as warranted by the specifics of the situation.*

### 2.2.3.1 Common Management

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 17(3)(a)*

The Minister must consider whether all project-related activities, facilities, and assets are under common management. This does not mean that a project may not have various owners, but planning, management and operations must be integrated so that the project functions as a single unit for royalty calculation purposes.

### 2.2.3.2 Location Requirements

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 17(3)(b), (c) and (e)*

The Minister must consider whether all components of an OSR project comply with the location requirements specified in the Regulation.

#### 2.2.3.2.1 Project Components (Except Upgraders)

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 17(3)(c)*

The Minister must consider whether, except for upgraders, any component of an OSR project is located more than 50 kilometres from any other component. That is, whether the two most distant points are no more than 50 km apart.

#### 2.2.3.2.2 Upgraders

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 17(3)(b)*

Upgraders and the pipelines that connect them to other project components are not subject to the 50-kilometre restriction. However, the Regulation stipulates that the Minister must consider whether upgraders are located in Alberta.

#### 2.2.3.2.3 Exceptions

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 17(3)(e)*

In exceptional circumstances, components located outside the 50-kilometre guideline *may* be approved as part of an oil sands royalty project. Such components will not be considered for inclusion unless the applicant can clearly demonstrate that all of the following criteria have been met:

- *The proposed out-of-project-area component must be “substantially geographically contiguous” with other parts of the project.*
- *It must be operationally integrated with the rest of the project.*

- *It must comply with the cost criteria specified in the Regulation.*
- *Including it as part of the OSR project description must provide significant economic and operational synergy.*

If these criteria cannot be demonstrated to be met, to the satisfaction of the Minister, the proposed component will not be included in the OSR project.

### 2.2.3.3 Projects as Economic Units

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 17(3)(d)*

The Minister must consider whether or not each part of the project is economically justified. The project design, development plans, facilities and boundaries must all be justifiable for business and economic reasons. In addition, each component of the project must be economically justifiable and operationally integrated. Project components may include all operations, equipment and facilities associated with the recovery and processing of oil sands, and with the transportation of oil sands products to the project's boundary.

#### A Note on Terminology

The definition of an economic unit for the purposes of oil sands royalty may differ from the developer's definition of an economic unit.

The economic unit that constitutes an oil sands royalty project includes **only** those components that the Minister considers directly related to oil sands recovery, processing and transportation within the approved project area.

From the developer's perspective, these components may be part of a larger project that includes facilities or operations outside the OSR-approved project area. An example would be an upgrader. A developer may choose to have the upgrader excluded from the OSR-approved project, even though it is part of the developer's oil sands project.

#### 2.2.3.3.1 Economic Justification for Project Expansions

The generic oil sands royalty regime has flexibility to facilitate staged development. This means that, over time, a project may expand and grow. As long as a project's growth is reflective of existing operations, albeit carried out on a larger scale or larger production base, the Minister may approve an amendment to the project approval order. (see 2.1.1.2, "Project Amendments")

The Minister *will likely not* approve a project amendment once the project has reached a size when further growth would not create economies of scale. In this case, the developer would need to apply for approval for a new, stand-alone project.

#### 2.2.3.3.2 Economic Justification for Project Amalgamations

The Minister *may* approve the amalgamation of oil sands royalty projects if this is economically justifiable. In making this determination, the following principles will be considered:

- Whether or not a project is capable of sustained production.
- Whether or not a project has a cost balance that is unlikely to ever be recovered.

**Amalgamated projects** must adhere to the same criteria as all other projects: they must have Board\* approval(s), and satisfy the common management and the 50-kilometre limit considerations. Furthermore, the amalgamated project must be justified for economic reasons. If any other aspect of the proposed definition for the amalgamated project does not materially benefit a project's profitability, the Minister will likely not approve the **amalgamation**. The Minister will also consider the Crown's royalty share\* from the amalgamated project. The practice of the Minister has been that if any portion of the amalgamation results in a shift of the Crown's royalty share away from the Crown and to the project owners, the Minister will not consider approving the amalgamation unless it is revised to protect the interests of the Crown.

#### 2.2.3.4 Protecting the Crown's Royalty Share

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 17(3)(f)*

The project must be viable and there must be a legitimate expectation of profit—including a reasonable return on investment. In addition, the project must not be structured in a way that reduces the amount of royalty payable to the Crown.

In reviewing oil sands royalty applications, the Department determines if any aspect of the project would shift royalty away from the Crown. It looks at how project descriptions may impact the present value of future cash flows to the project owners and the Crown.

An OSR project approval order will not be issued if any aspect of the proposed project

- does not contribute to the project's profitability (including royalty share), or
- shifts revenues to the project owner at the expense of the Crown

In such situations, the application will not be approved until revisions have been made to protect the interests of the Crown.

##### 2.2.3.4.1 Crown Royalty and Project Expansions

Two criteria are used to evaluate the royalty impact of project expansions:

- present-value royalty impact
- time to reach payout

##### **present-value royalty impact**

The Department compares the present value of royalty that would be payable by the expanded project to the present value of royalty that would be payable if the proposed expansion and the existing project were treated as separate projects.

The long-term bond rate\* (LTBR) (see 4.2.1, "The Return Allowance") is used as the discount rate in determining the present value of the royalty cash flows. The analysis assumes

- that expenditure and production data are the same whether the project expansion is approved or not

- that the expected costs and production data for all future years of both the existing project and the proposed expansion have been included in the application to amend the project

### **time to reach payout**

The Department compares the time it would take the expanded project to reach payout to the time it would take for payout to be reached if the proposed expansion and the existing project were treated as separate projects.

For example, if the current project was expected to reach payout in 7 to 8 years, an expansion that doubled the scale of the project would be expected to delay payout by roughly 4 years: a longer-term delay would be considered unreasonable. A smaller-scale expansion would be expected to delay payout for less than 4 years. A larger-scale expansion might delay payout for more than 4 years.

## **2.3 The Components of an Oil Sands Royalty Project**

The information components of an oil sands royalty project include

- the project name
- the project approval order number
- the project owner(s) and ownership considerations
- the project operator
- the lands and leases that have been approved as part of the project
- the project operations, including the recovery method and technology that have been approved, the product that will be produced and the approved production capacity
- project facilities (including the required EUB approval orders) and infrastructure
- the effective date of the project
- the project's prior cumulative net balance

These information components are specified in applications for approval of an OSR project and in the appendices and attachments accompanying the Ministerial Order issued when an OSR project is approved.

### **2.3.1 The Project Name**

The project name, in conjunction with a Department-assigned project approval order number, serves to identify the project in Department of Energy information systems and records.

The name assigned to a project should serve as a specific identifier (for example, Elk Point Project or Project ABC). The name should remain applicable for the duration of the project, regardless if owners, operators or project specifics change.

*Since ownership arrangements may change over time, the names of project owners should not be included as part of a project name.*

### 2.3.2 The Project Approval Order Number

A provisional project approval order number is assigned when an oil sands royalty project application is received by the Department. Project approval order numbers begin with the prefix OSR (for Oil Sands Royalty). They are assigned sequentially: OSR 001, OSR 002 and so on.

If the OSR project application is approved, the project approval order number forms part of the project approval document. Together with the project name, it identifies the project in the Department's information systems and records.

The OSR project approval order number generally applies throughout the life of a project. If a project is amended, a letter is added to the number. For example, if Project OSR 001 is amended, its project approval order number normally becomes OSR 001A. If it is amended again, its project approval order number normally becomes OSR 001B, then OSR 001C and so on.

*The OSR project approval order number should be cited in all correspondence with the Department.*

### 2.3.3 The Project Owner

The project owner is an individual or corporation that has leased the right to develop and use oil sands resources from a defined land area or subsurface stratum. The extent and duration of the owner's rights are specified in an oil sands agreement called a lease. The project owner is often called the lessee.

An oil sands royalty project may have single or joint ownership. When there is more than one owner, each owner's equity share and obligations for royalty payment are specified in an operating agreement.

*Operating agreements must be filed with the Department as part of the application for OSR project approval. The Department must be notified in writing if there is a change in project ownership.*

#### Project Owner: A Legal Definition

As defined in *section (1)(cc)* of the Regulation, a project owner is the **lessee of oil sands rights**, or, in the case of freehold mineral rights, the person who, according to Land Titles Office records, **has the right to recover oil sands** from the development area\* of a project.

### 2.3.4 Ownership Considerations

#### 2.3.4.1 Freehold Interests

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 16(1)(b)*

When freehold mineral rights are included as part of a proposed oil sands royalty project, a unit agreement\* is required before a project can be approved. The unit agreement is made between the owner of the freehold mineral rights and the Crown. It specifies the terms that govern the sharing of production costs and revenues.

*Unit agreements must be filed with the Department as part of the application for OSR project approval.*

### 2.3.4.2 Qualifying Joint Ventures

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 19*

Some types of jointly owned oil sands royalty projects are considered qualifying joint ventures under the Regulation. The cost rules for qualifying joint ventures are slightly different from those for other jointly owned OSR projects, which are referred to as non-qualifying joint venture projects\*. In calculating royalty, the cost of basic research is an allowed cost for qualifying joint ventures, but not for non-qualifying joint venture projects. For qualifying joint ventures, fees related to the management of the joint venture are not allowed. Fees related to the marketing of oil sands products are also not allowed unless they are incurred by the project operator.

In order to be classified as a qualifying joint venture, an oil sands royalty project must meet all the following criteria:

#### **ownership structure**

- The joint venture must have two or more project owners.
- The owners must be independent entities.
- No owner or group of owners may hold a majority interest in the project.
- The ownership structure must be the same for all aspects of the project, including all project-related agreements, freehold lands and facilities.

#### **purpose**

- The sole purpose of the joint venture must be the production of oil sands products from the operations and facilities included in the project description.

#### **project operator**

- The operation and management of the project must be the sole business activity of the designated project operator.
- The project operator must have no income and no deductions for the purposes of the *Income Tax Act* (Canada).

*The operating agreements for qualifying joint venture projects must be filed with the Department as part of the application for OSR project approval.*

### 2.3.5 The Project Operator

*Oil Sands Royalty Regulation, 1997 (AR 185/97), sections 1(r) and 16(2)(a)(v)*

The project operator is the person or corporation responsible for the management and operation of an oil sands royalty project. Project operators have the legal authority to represent the project and its owners.

Project operators are responsible for

- filing project reports, including operator's forecasts, monthly reports and end of period statements\*

*Oil Sands Royalty Regulation, 1997 (AR 185/97), sections 27, 28 and 29*

- maintaining records suitable for audit (project owners have this responsibility as well)

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 30*

- paying royalty

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 31*

- paying penalties or interest charges levied under the terms of the Regulation

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 32*

- keeping the Department informed about changes to contact information, project ownership or other project-related details

The project operators may apply for oil sands royalty project approval as the designee of the project owners. In some cases, the project operator is also the owner of the oil sands project. If the operator is not the owner, or is one of several owners, the project operating agreement must be included as part of an application for OSR project approval. The operating agreement verifies that the designated operator is authorized to represent the project.

If the project operator should change, the Department must be notified in writing. The Department will not accept royalty payments from or release project-related information to anyone but the authorized project operator.

### 2.3.6 Lands, Leases and Mineral Rights

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 17(1)(b)*

An oil sands royalty project comprises the surface area and subsurface oil sands strata that will be used to produce or process bitumen. Collectively, the lands and subsurface strata that are included in the project description are called the project development area.

#### 2.3.6.1 Project Leases

The mineral rights included in a project are identified by an oil sands lease number.

Subsurface strata are identified by EUB zone designations\* or deeper rights reversion zone designations.

#### 2.3.6.2 Project Lands

The surface areas included in a project are identified by the Dominion Land Survey System description that indicates the relevant section, township, range and meridian:

- for example, Section 12, Township 64, Range 6, West of the 4th Meridian (This can also be written as 12-064-06 W4M.)

*Except for upgraders, no part of an oil sands royalty project can normally be more than 50 km away from any other part.*

### 2.3.7 Project Operations

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 17*

Project operations include all the activities required to recover, process and transport the approved project output (i.e., oil sands products) to the project boundary. If a project includes an upgrader located outside the boundary, project operations may include transporting the output to the upgrader.

#### 2.3.7.1 Recovery Methods and Other Technology

Depending on the nature of a project, project operations may include activities such as

- primary recovery
- secondary recovery (e.g., waterflood, emulsion flood)
- thermal recovery
- solvent recovery
- mining
- on-site transportation and processing (cleaning)
- provision of thermal energy, with or without electricity generation
- storage until the product is transported to market
- upgrading

The recovery methods and technology approved for an oil sands royalty project are specified in the OSR project approval order.

#### 2.3.7.2 Oil Sands Products

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 1(q)*

An oil sands royalty project may produce one or more of the following products:

- dirty crude bitumen (see 4.6.1, "An OSR Project that Produces Crude Bitumen"—Royalty will be charged as though the product was cleaned)
- cleaned crude bitumen\*
- synthetic crude oil\*
- sulphur, metals, or other products (except natural gas) obtained by processing or reprocessing oil sands
- "off-gases" produced from processing or reprocessing bitumen

The approved production capacity for each approved product may be specified in the OSR project approval order.

### 2.3.8 Facilities and Capital Assets

The facilities and capital used by a project are specified and approved in the oil sands project approval order.

#### **Facilities**

Examples of project **facilities** include:

- disposal facilities
- steam generation plants
- cleaning or treatment plants
- cogeneration plants
- upgraders
- other facilities related to oil sands production

#### **Capital Assets**

Examples of **capital assets** include:

- wells and batteries
- injection wells (including steam, solvent and other types of injection facilities)
- observation or delineation wells
- source water wells
- water monitoring wells
- disposal wells
- infrastructure such as roads, buildings, bridges, electricity transmission lines or other project assets
- pipelines used to connect project components or transport outputs to a project boundary. (Sales pipelines are not eligible as components of oil sands royalty projects.)

If the Minister has approved a particular asset or facility\* as part of an OSR project description, eligible costs that are attributable to the approved asset or facility are considered allowed costs that can be deducted for royalty calculation purposes. The revenues attributable to the approved asset or facility must also be claimed as "other net proceeds\*."

*The Minister will not approve facilities or capital assets that do not meet the requirements for OSR projects. Approved project facilities and assets are specified in the OSR project approval order. Facilities and assets cannot be added or removed from a project unless permitted under the OSR project approval order, or unless an application to amend the OSR approval order is approved by the Minister. (see 2.1.1.2, "Project Amendments")*

### 2.3.8.1 Shared Facilities

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 17(2)*

When processing facilities are co-owned with another project, processing costs are allocated in proportion to each project's ownership. For example, a project owner who owns a 50% share of the processing facility can claim 50% of the facility costs as allowed costs.

If the processing is not in the same proportion as the ownership, a cost equalization payment is made to account for the difference. The cost equalization payment is considered to be custom processing, which is treated as other net proceeds (see Figure 4, in 4.6.3, "OSR Projects with Jointly Owned Facilities").

The capital and operating costs of a shared facility such as the operating control room for cogeneration plants or for stand-alone steam and electricity power plants is allocated to steam and electricity in direct proportion to the capital cost of the facilities incurred for their respective "unshared" or single purpose facilities.

### 2.3.9 The Effective Date

*Oil Sands Royalty Regulation, 1997 (AR 185/97), sections 16(2)(a)(ii), 16(2)(b)(ii) and 16(3)*

The effective date of an oil sands royalty project is the date from which royalty begins to be calculated under the terms of the *Oil Sands Royalty Regulation, 1997 AR (185/97)*.

A provisional effective date is assigned when the Department receives a complete OSR project application. The provisional date is confirmed or revised (if necessary) during a project approval process. The project's official effective date is identified in the project approval document.

The Department cannot assign a provisional effective date until a complete project application—including the required EUB approvals, complete costs and revenue data and project economic forecasts—has been provided.

The effective date is the later of the following two dates:

- first day of the month in which the application was received
- the first day of the month *following* the month in which EUB approval was granted

For example, suppose the Department receives an OSR project application on June 23. EUB approval is granted on June 16. The project's effective date is July 1—that is, the later of June 1 (first day of the month in which the application was received) and July 1 (the first day of the month *following* the month in which EUB approval was granted).

*Section 16(3)(c) of the 1997 Oil Sands Royalty Regulation states that the provisional effective date cannot be earlier than the first day of the month that precedes by 9 months the month in which the project or project amendment is approved by the Minister.*

### 2.3.9.1 Deferrals

Oil sands royalty project applicants may wish to defer the effective dates of their projects. In this case, the Department may assign an effective date that is later than what would normally be assigned under the terms of the Regulation.

*Requests for a deferred effective date must be included with the project application.*

### 2.3.9.2 EUB Approvals and Effective Dates

Schemes, operations, and facilities that are approved by the EUB after a project's effective date are not considered part of the project. Their associated costs and revenues cannot be used as part of the royalty calculation unless a project amendment application is approved.

### 2.3.10 Prior Net Cumulative Balance

Oil Sands Royalty Regulation, 1997 (AR 185/97), section 18

The prior net cumulative balance (PNCB) of an oil sands royalty project is the **opening balance\*** of cumulative costs less cumulative revenues incurred within a limited time period prior to the project's effective date. The opening balance is sometimes also referred to as the **unrecovered balance**.

The definition of project payout recognizes that balances are fluid. Once an oil sands royalty project has been approved, the unrecovered balance carries over from year-to-year. (Payout is the 1<sup>st</sup> day of the month at which, for a pre-payout project, there is no unrecovered balance.)

The prior net cumulative balance is the unrecovered balance at the point when an oil sands royalty project is approved. It is an important component of the payout calculation that determines the project's royalty rate.

A project expansion will have its own prior net cumulative balance initially. Upon the expansion being approved by the Minister, this opening balance will be rolled into the remaining unrecovered balance of the larger project if pre-payout project or will be added as a cost for a post-payout project.

Oil sands developers submit their calculations of prior net cumulative balance as part of their application for oil sands royalty project approval. Costs and revenues are disclosed on standard Department of Energy forms and reviewed by the Department as part of the application process. Through the course of the review, the Department removes or adjusts ineligible costs or costs that cannot be supported by the necessary paper trail. Applicants should submit summaries of authorizations for expenditures (AFE) or other corporate budgetary documents to substantiate their prior net cumulative balances. The resulting, Minister-approved prior net cumulative balance is identified in the project approval document. Prior net cumulative balance, as with any cost or revenue item, is subject to verification through a Crown audit.

## Notes

- Once a prior net cumulative balance (PNCB) has been defined as part of an OSR project approval, its period is fixed. The approved PNCB period cannot be changed by the project owner, operator or the Department.
- If an OSR project with an unrecovered balance is sold, the outstanding unrecovered balance remains fixed, regardless of whether the sales price\* was more or less than this amount.
- See 3.3.3.5.6, "Financial Details"

### 2.3.10.1 Eligible Costs

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 18(1)(a)(i)*

Capital and operating costs that are directly attributable\* to recovering, processing, and transporting oil sands products within the project's boundary may be included in calculating the project's prior net cumulative balance. The cost rules are the same, whether the cost was incurred before or after the project's effective date. (see 4.2.2, "Allowed Costs")

#### 2.3.10.1.1 Pre-project Royalty

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 18(1)(a)(ii)*

Royalty paid to the Crown under the *Oil Sands Royalty Regulation, 1984 (AR 166/84)* or under a Crown agreement is included as a cost in opening balance calculations for oil sands royalty projects.

### 2.3.10.2 Excluded Costs

*Oil Sands Royalty Regulation, 1997 (AR 185/97), section 18(1)(b)*

The Minister must take into consideration whether the following costs should be excluded or deducted from calculations of an oil sands royalty project's prior net cumulative balance:

- costs incurred during periods in which oil sands development was suspended or abandoned
- costs that would not qualify as allowed costs if they were incurred after the project's effective date
- any costs in respect of which allocable costs (as defined in the Innovative Energy Technologies Regulation) have been established
- the Crown's share of revenue received for project substances\* (corresponding to the costs incurred to recover those substances), and other revenue that would be considered other net proceeds had it been received after the effective date

**Note**

Costs incurred to recover oil sands or oil sands products to which the *Experimental Oil Sands Royalty Regulation* applied are not an allowed cost.

**2.3.10.3 Timing**

*Oil Sands Royalty Regulation, 1997 (AR 185/97), sections 18(1)(a)(i)(A to C)*

The opening balance calculation of an oil sands royalty project is limited to costs incurred up to three years before the project's effective date. The Minister *may* allow costs incurred in the 4<sup>th</sup> and 5<sup>th</sup> years before the effective date if the applicant can demonstrate "diligent and substantial action" was taken within that period to obtain the EUB approvals needed to develop or expand the project. Such action could include consulting with the EUB or local land owners.

Costs incurred more than five years before a project's effective date are usually not eligible for opening balance calculations. An exception may be made if the project owner can demonstrate that significant cost savings will result if the assets are used for the oil sands royalty project. An example could be the use of an existing cleaning plant, or the incorporation of an existing evaluation well (see 4.2.2.3.4, "Evaluation Well Costs Incurred More than 5 Years Before the Effective Date").

**Note**

An OSR project applicant must specify the time frame within which the project's opening balance was accumulated. Once this time frame has been specified, it cannot be changed