April 6, 2010

OIL SANDS INFORMATION BULLETIN 2010-06

Subject: Dispute Review Committee – Minister’s Decision

On March 4, 2009 the Minister established the first Dispute Review Committee to review the department’s interpretations that led to the disallowance of certain costs for an oil sands Project’s royalty calculation.

The Suncor Dispute Review Committee was established to review and make recommendations with respect to the Department’s decision to disallow certain costs for Project OSR047 and for Project OSR050. The Committee, upon hearing the parties, made the attached recommendations to the Minister of Energy (the “Minister”), who under the Oil Sands Dispute Resolution Regulation (OSDRR) could decide to accept, reject, or vary the recommendations. The Minister has made his decision in respect of the recommendations, and it is also attached to this Bulletin.

In summary:

• A hearing before the Committee was conducted on October 20th and 21st, 2009.
• The Committee issued its recommendations on November 4, 2009.
  Refer to Appendix “A” for the Committee’s report.
• On March 24, 2010 the Minister made a decision on the Committee’s recommendations through Ministerial Order 32/2010. Refer to Appendix “B” for the decision.

Please contact Don Petruk, Director of Dispute Resolution, at (780)427-6397 or Don.Petruk@gov.ab.ca if you have any questions about the dispute resolution process.

Anne Denman
Executive Director
Oil Sands Operations

Attachments
IN THE MATTER of the Oil Sand Dispute
Resolution Regulation A.R. 247/2007

AND IN THE MATTER of the Suncor Oil Sands Dispute
Review Committee, as established by
Ministerial Order 20/2009

BETWEEN

Suncor Energy Inc.

Applicant

-and-

Alberta Department of Energy

Respondent

REPORT AND RECOMMENDATIONS
OF THE DISPUTE RESOLUTION COMMITTEE

Dispute Resolution Committee

Phyllis A. Smith, Q.C., Chair
Peter Taschuk, Q.C.
David Tavender, Q.C.
I. INTRODUCTION

1. Pursuant to the Oil Sands Dispute Resolution Regulation1, this Dispute Review Committee ("the Committee") was appointed by the Minister of Energy2 to review and provide recommendations to the Minister with respect to a dispute between Suncor Energy Inc. ("Suncor") and the Department of Energy ("the Department").

2. The order directed the Committee to hear certain matters in dispute arising from the Department's royalty audit for the years 2001, 2002 and 2003 relating to Suncor Projects 047 and 050 and specifically relating to, with respect to Project 047, the pipeline cost of service, community support and consultation costs and charitable donations, and with respect to Project 050, community support and consultation costs3.

3. The disputes were:
   (a) with respect to pipeline cost of service, a disagreement as to what constituted the undepreciated capital cost ("UCC") of the pipeline for the purpose of determining the cost of service of the pipeline as defined in section 7.1(2)(c) of the Oil Sands Royalty Regulation, 19974 ("OSRR-97");
   (b) with respect to community support and consultation costs, and charitable donations, a disagreement over whether such costs were allowed costs of Projects 047 and 050 as defined in Schedule 1 of OSRR-97.

4. The parties made written submissions and replies as contemplated by the Oil Sands Dispute Resolution Regulation5, and after reviewing those submissions and replies the Committee determined that an oral hearing was required for the purpose of clarification of and further response to the parties' written submissions and replies. As there appeared to be no material dispute with respect to the facts the Committee directed that an evidentiary hearing was not required.

5. The oral hearing was held at the law offices of McLennan Ross in Edmonton on October 20 and 21, 2009. In attendance at the hearing were the following persons:
   For Suncor:                      For the Department:
   Louise Novinger-Grant, Counsel  Todd Nahimik, Counsel
   Alicia Quesnel, Counsel          David France, Counsel
   Jennifer Veazari, Counsel        Elizabeth San Regret
   Greg Frieden                     James Weber
   Eric Axford                      Steve Tkalic
   Martin Smith                     Colin Pate
   Shawn Poirier                   Peter Mittal
   Muniv Jirvaj                     Roseann Summers
                                    Chris Lawton

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1 A.R. 247/2007
2 Ministerial Order 26/2009
3 Schedule A to the Order
4 A.R. 185/97
5 S.9(8) and (9)
6. In making its findings and recommendations the Committee has relied upon the written submissions and replies filed by the parties and the further submissions made at the oral hearing of October 20 and 21, 2009.

II. PRELIMINARY PROCESS RELATED MATTERS

7. The Committee dealt with two preliminary matters with respect to the dispute which may require some further consideration by the Minister in connection with future disputes subject to the Oilsands Dispute Resolution Regulation.

8. The first issue involved the process for determining whether an oral hearing was required. Under the Oilsands Dispute Resolution Regulation, the Committee is not bound to hold an oral hearing. But the regulation as currently structured appears to contemplate that a decision is to be made with respect to an oral hearing prior to the filing of written submissions. However, in the absence of written submissions, it is difficult, if not impossible to assess whether an oral hearing is necessary to meet the requirements of procedural fairness or to deal with factual or other issues. As a result the Committee deferred rendering a decision as to whether an oral hearing would be held until after the parties had submitted their written submissions, but directed the parties to include in their written submissions the information required by section 9(9)(b) of the regulation, in the event that the Committee determined that an oral hearing would be required. The Committee then considered the written submissions and replies after they were filed and used those submissions and replies to make its decision to hold an oral hearing, restricted to further submissions as opposed to the calling of evidence. The Committee adopted this process pursuant to its duties and powers as set out in section 9(1). If the drafters of the regulation intended that some other process was to be used to determine whether an oral hearing would be held, some revision to the Oilsands Dispute Resolution Regulation may be required.

9. The second issue involved the issue of intervenors. Three third parties (Syncrude, Imperial Oil, and Shell) applied for intervenor status on the grounds that the Committee was considering issues that were likely to be or had been raised in audits dealing with their royalty calculations. Those parties pointed to section 8(2) of the Regulation which gave the Minister the discretion to refuse to appoint a dispute resolution committee if the Minister is of the opinion that “the subject-matter of the dispute has been dealt with by a previous committee”. They argued that this could potentially deprive them of the opportunity to have their issues dealt with by a committee if this committee dealt with the same issues, thereby depriving them of procedural fairness. The Committee determined that the scheme of the regulation was one that did not contemplate the participation of intervenors in the process nor was the Committee satisfied that the proposed intervenors would provide a unique or different perspective from Suncor with respect to the matters before the Committee. The Committee dismissed the applications by the third parties for

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3 S. 9(5). It is further to be noted that the timing of the written submissions and replies under Section 9(8) are tied to a date when the matters in dispute are to be reviewed by the committee. It is not clear whether that committee review is intended to be a formal oral hearing involving the parties.

4 S. 9(9)(b)
intervenor status. If the Minister is of the view that interventions by third parties in
disputes involving issues that are common to a number of royalty payers would be
appropriate, it may require consideration of revision to the regulation to make that clear.

III. PIPELINE COSTS

A. The Dispute

10. The dispute with respect to pipeline costs arises because of a change in treatment of the
pipeline for royalty purposes. The pipeline was originally considered part of Project 047
("the Project"). Consequently all of the costs were wholly deductible for royalty
calculation purposes as they were incurred. However in 1997, the use of the pipeline
changed to a multi-purpose use including the transport of materials unrelated to the
Project. That change of use involved both significant capital costs and an exclusion of
the pipeline from the Project. In such circumstances the cost of using the pipeline for the
transport of oil sands product must be determined on the basis of a cost of service model
which requires the determination of an UCC for the pipeline asset.

11. However from 1997 to 2001 Suncor continued to deduct the full amount of capital costs
as they were incurred. Consequently Suncor for the purpose of royalty calculations wrote
off 100% of the capital costs incurred in each of the years 1997 and 1998 (approximately
$[redacted]) and a further sum of approximately $[redacted] in 1999 and 2000. This was
identified as an error by the parties in 2005 as a result of the Department’s audit.

12. The issue is how the pipeline is to be treated moving forward from January 1, 2001 for
the purpose of royalty calculation.

13. The Department has concluded, for the purpose of determining the cost of service of the
pipeline, that the UCC is an amount equal to the capital costs that had not yet been
deducted for royalty calculations. It asserts that having regard to the entirety of the
royalty scheme, the provisions of OSRR-97 and the provisions of the Mines and Minerals
Act9 Suncor cannot in effect double dip by using the previously claimed 100% of the
capital costs a second time for the purpose of royalty calculation. The Department has
consequently determined that the UCC for the period commencing January 1, 2001 is
$[redacted] million. The Department further claims that this is a generous assessment of UCC
as no straight line depreciation deduction was applied to the outstanding costs.

14. Suncor asserts that the proper UCC is the capital cost incurred less depreciation
calculated on a normal straight line basis. Suncor further claims that the Department

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8 Whether it is an error or not is a matter of debate as while Ministerial Order 51/2003, the Project Approval Order
No. OSR5047, in Part 2, section 1(d) excluded the pipeline, Part 1, Inclusions, s. 8, provided that notwithstanding any
other provision (which would include Part 2), up to January 1, 2001, the Suncor Project was deemed to include any
facilities for which Suncor claimed allowed costs for royalty purposes for 1967 to 2000 and the costs were not
disallowed prior to January 1, 2005 in the audit process. Consequently it appears that since Suncor claimed such
costs for the pipeline and they were not disallowed prior to January 1, 2005, the pipeline is deemed to be part of the
Project up to January 1, 2001.
9 R.S.A. 2000, c. M-17
cannot take into account what occurred prior to January 1, 2001 as section 38 of the Mines and Minerals Act limits royalty adjustments to periods not longer than four years prior to the adjustment. It further claims that pursuant to section 11 of the Regulation, generally accepted accounting principles (GAPP) apply to royalty calculations and the Department’s determination of the UCC is not in accordance with GAPP and nothing in OSRR-97 permits the calculation of UCC in the manner determined by the Department. Suncor’s calculation of UCC using GAPP methodology is approximately $1,000,000.

B. Committee Recommendation

15. The issue before the Committee is whether Suncor is entitled to treat the pipeline as though no costs of that pipeline had been previously claimed for royalty calculation purposes when as a matter of fact almost the entirety of the costs had been claimed for royalty calculation purposes.

16. In essence Suncor is saying that the Department cannot determine the cost of the asset for cost of service purposes on the basis of what remains after previous deductions but must treat it as though no such deductions had been made.

17. Suncor’s primary assertion is that section 38 of the Mines and Minerals Act operates so as to prevent any consideration of what has occurred more than four years prior to the identification of the error.

18. Section 38 in general terms permits the Minister to recalculate or make additional calculations respecting a number of matters within four years after the amounts became owing or the amounts were first calculated or the mineral was recovered depending on the subject of the recalculation. Suncor says that the effect of what the Department proposes is to in effect permit such recalculation indirectly, and that the Department ought not to be able to do indirectly what it cannot do directly.

19. Suncor asserts that in the face of section 38 of the Mines and Minerals Act, the Department cannot take into account the fact that the capital costs of the pipeline were largely previously claimed as a deduction for royalty purposes, being deductions taken more than four years prior to the 2005 audit process which identified the erroneous methodology, because:
   (a) there is no specific provision that would permit this in the Act or Regulation, and;
   (b) it is contrary to GAPP and therefore contrary to section 11 of the Regulation.

20. The Committee has considered these arguments together with the arguments of the Department. It is of the view having considered those arguments that the Department’s position ought to be accepted. It says this for a number of reasons.

21. Firstly, the scheme of the regulation is, in the opinion of the Committee, designed to create a fair royalty scheme which balances the interest of the developers with the interest of the resource owner while encouraging the development of the resource. That the interests of the resource owner are to be as protected as the interests of the royalty payer
is evident from a consideration of section 37 of the Mines and Minerals Act which is designed to prevent an artificial or undue reduction in royalty. Using costs that had already been utilized to obtain a royalty reduction in previous years, in the opinion of the Committee, results in an artificial or undue reduction of royalty. Such an act, in the Committee’s view, is an "act" as contemplated by section 37.

22. The Committee is further of the view that the provisions of the regulation itself provide specific direction as to what might constitute an artificial or undue reduction in royalty. The Committee specifically refers to section 21 of the Regulation. This section precludes inclusion as a handling charge for the purpose of calculating unit price, any costs that have been allowed costs or costs taken into account in determining the prior net cumulative balance of the Project or Project expansion. But more importantly the Committee refers to section 7.4(2)(a) of the Regulation which specifically provides that the net book value of an asset is the undepreciated portion of the cost in the books of the Minister when royalties payable to the Minister under the Mines and Minerals Act (other than under OSRR-97) have been reduced by those costs. Some $ million of the costs now claimed to be part of the UCC of the pipeline by Suncor in fact reduced royalties payable pursuant to an agreement under the Mines and Minerals Act and not this regulation, and therefore the Minister is entitled to use the Department’s records for the determination of the UCC. In that regard the Committee expressly rejects Suncor’s argument that royalties paid pursuant to an agreement authorized by the Mines and Minerals Act is not a royalty payable under the Mines and Minerals Act.

23. The Committee is further of the view that section 38 of the Mines and Minerals Act was not designed to nor does it prevent the Department from using a UCC which reflects that costs were actually deducted previously, even if those deductions occurred more than four years prior to the Department’s audit. Section 38 is a limitation provision which is to be strictly construed against the party relying upon it. What it does in the opinion of the Committee is to prevent the Department from recalculate royalty payments or other costs used to calculate the royalty payment in any year which is statute barred under section 38. But the Department is not seeking to do that. It is seeking to calculate the proper basis for royalty payments commencing in 2001 and thereafter, which are not statute barred years.

The Committee therefore recommends that for the purpose of calculating the cost of the pipeline the UCC is $ million, being the net book value according to the records of the Department, and that Suncor’s appeal of this determination be rejected.

IV. DISALLOWED COSTS

The reference to section 21 is not academic. Pursuant to section 8(a) of the Project Approval Order, significant costs were claimed as allowed costs for royalty purposes from 1997 to 2000 and not disallowed in the course of audit completed prior to January 1, 2005.
A. The Dispute

24. The Department disallowed community support and consultation costs and charitable donations claimed by Suncor with respect to Projects 047 and 050 ("the Projects") for the years 2001, 2002, and 2003.

25. Both Suncor and the Department indicated that there was a dispute between them with respect to how Schedule 1 of OSSR-97 was to be interpreted. Consequently neither party had carried out any detailed analysis of the various disallowed costs. Nor was such analysis and evidence presented to the Committee. Both parties were of the view that what they required from the Committee was direction as to the general principles to be utilized in applying the cost rules in Schedule 1 to OSSR-97, so that those principles could be applied by the Department on a line by line basis once additional specific information was exchanged between the parties.

26. Suncor did produce schedules of the disallowed costs for the Projects which categorized the costs based on the analysis contained in Suncor’s argument 11. There were eight categories:

   Category 1 – Mitigation and consultation funding to First Nations/Aboriginal/Metis entities affected by Project 047 or 050
   Category 2 – Payment to facilitate First Nation/Aboriginal/Metis employment at Project 047 or 050
   Category 3 – Good Neighbour funding to the communities affected by or proximate to Project 047 or 050
   Category 4 – Mitigation funding to regional groups working on the impacts of the Projects
   Category 5 – Payments for the benefit of Suncor employees
   Category 6 – Payments for community celebration related to Project opening
   Category 7 – General Suncor operating expense related to the Projects
   Category 8 – Payment to facilitate Suncor’s participation in general industry related projects

27. The Department took some exception to the introduction of these new descriptors for the costs during this process but the Committee found that the descriptors were helpful in gaining an appreciation of the nature of the costs disallowed by the Department and Suncor’s justification for the costs. It also provided a useful focus to the discussions at the oral hearing.

28. The parties’ primary focus in their submissions related to the interpretation of sections 2(a) and 2(e) of Schedule 1 of OSSR-97 and what sources the Committee ought to consider to assist in determining the intention of the legislation. Essentially Suncor argued for a broad interpretation favourable to the royalty payer and the Department

11 Attached to this report as Schedules 1, 2 and 3
argued for a narrow interpretation of the governing provisions, consistent with achieving a fair rental for the resource owned by the Crown. Both recognized however that the primary determinant of the intention of the legislation is the words used by the draftsman and that the plain meaning of those words is what those applying the legislation are to first look at, and it is only in the case of ambiguity unsolvable by simply looking at the words used that general principles of statutory interpretation are to be resorted to.

29. The primary source relied upon by Suncor in support of its very expansionist interpretation of section 2 of Schedule 1 of OSRR-97 was the report of National Oil Sands Task Force. Suncor said that because that report was the underlying driver for the new royalty regime reflected in OSRR-97, the goals and objectives espoused in that report must be viewed as the goals and objectives of the new royalty regime, and in particular the emphasis in that report for adopting policies and programs that would strongly encourage private sector development of the oil sands. Consequently the cost rules set out in the regulation must be interpreted having that objective in mind, which in turn requires a liberal interpretation of the costs rules to the benefit of the royalty payer.

30. The Department disputed the weight, if any, that should be given to the National Task Force Report, saying that it is necessary to distinguish between a regulation that was motivated by a report and a regulation whose provisions are based upon the recommendations contained in the report. It pointed out that the Province did not adopt all of the recommendations of the Report, and in particular pointed to the rejection of the no gross royalty recommendation. This was important in any consideration of whether that Report should guide the interpretation of the regulation, as it clearly meant that the regulation was intended to be at the very least a balancing of the interest of industry and the resource owner. Therefore reference to the Report is not appropriate to justify an expansionist and liberal interpretation of the cost rules for the purpose of benefitting the royalty payer.

31. With respect to the specific interpretation issues, Suncor argued that the words, “directly attributable” used in section 2(a) of Schedule 1 of OSRR-97 means “but for” the projects the costs would not have been expended. The Department says that “directly attributable” in that subsection means “solely attributable”.

32. With respect to section 2(e), Suncor says that “incurred to” with respect to the specific activities listed in that section means any cost directly or indirectly expended to accomplish the activities set out in that subsection. The Department says that “incurred to” requires that there be a direct and substantial relationship to the activities described in that subsection and that Table 1 at the end of the Regulation provides a useful guide as to the types of costs contemplated to be allowed for royalty purposes.

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12 The Oil Sands: A New Energy Vision for Canada
13 The Committee notes that the Suncor/Crown Royalty Agreement used the words “in connection with” rather than “incurred to”.
14 That table lists the costs of acquiring, construction or replacing property plant and equipment, costs of deposits acceptable to the Crown with respect to reclamation, costs of labour, services and supplies necessary for the operation of the Project, costs of utilities services, including costs of utility service agreements, costs of repairs and maintenance.
33. In the result, while both parties agreed that the requirements of section 2 are cumulative, in that each and every one must be met before the cost is allowed under that section, they differed as to whether, with respect to the types of costs claimed by Suncor and disallowed by the Minister, such costs fell squarely with section 2 of Schedule 1.

34. While each of the parties addressed the meaning to be attached to subsections (a) and (e) in general terms much of the discussion related to how their proposed interpretation applied to either include or exclude the disallowed costs from section 2 of the Regulation.

35. In particular there was significant discussion with respect to Suncor's continuing obligations to the community pursuant to ERCB guidelines. Suncor asserted that it was required to comply with these guidelines in order to both obtain and maintain its permit, and that failure to do so would potentially jeopardize its permit, given that the ERCB retained jurisdiction to rescind or amend the permit. The Department asserted that while activities and resulting costs engaged in to secure a permit from the ERCB may be viewed as being costs incurred to recover oil sands from the development area of the Project, post approval community support and consultation costs and charitable donations are not unless the ERCB made the expenditures a condition of the permit approval.

36. Suncor also raised issues about the inconsistency of treatment of allowed and disallowed costs under the Crown Royalty Agreement which governed its royalty payments prior to OSRR-97 and the treatment that the Department urges is the appropriate treatment under OSRR-97. Suncor argued that the Department is estopped from advancing an interpretation of section 2 of Schedule 1 which would preclude Suncor from claiming as allowed costs, those costs that were treated as allowed costs under its previous agreement with the Crown. Alternatively, Suncor argued that the Department's current position as to the meaning of section 2 of Schedule 1 of OSRR-97 represents a change in meaning which cannot be applied to Suncor because of the provisions of section 10 of the Suncor Transition and Amending Agreement which brought Suncor under the provisions of OSRR-97 for the purpose of royalty payments.

B. Analysis

General Principles

37. The Committee carefully considered the submissions of the parties with respect to the interpretation of sections 2 and 3 of Schedule 1 of OSRR-97.

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14 ERCB Approval No. 8335, s. 16; see also Oil Sands Conservation Act, RSA 2000, c.O-7, s. 9(1), 13(1), 15(1), 17(1), 19(1).
15 Second Amendment and Transition Agreement made March 5, 1997
38. Before addressing the general issues of interpretation, the Committee has also considered the submissions of Suncor with respect to the effect of section 10 of the Transition and Amending Agreement and with respect to estoppel.

39. With respect to the latter issue the Committee is not convinced that the essential elements of estoppel have been proven, particularly in circumstances where the royalty regime under the Suncor Royalty agreement and the Regulation differed both in nature and wording. Furthermore there is no persuasive evidence that there has been a significantly different treatment of costs for the purpose of determining whether they are allowed given the vagaries of the audit process and the lack of information about the results of previous audits.

40. With respect to section 10 of the Transition and Amending Agreement, the Committee is not satisfied that there has been a change in meaning ascribed to "allowed costs" and therefore is not satisfied that the Department's current position triggers section 10(3) of the Transition Agreement so as to preclude the Department from disallowing the costs claimed by Suncor.

41. In general terms the Committee considers that the provisions of OSRR-97 are intended to provide for a royalty scheme which balances the interests of industry who develop the oil sands projects and the Crown which owns the resources being developed. Suncor's assertion that the purpose of OSRR-97 was to encourage development tells only part of the story.

42. In that connection, the Committee is of the view that while the National Task Force Report provides useful context it is not of great assistance in determining the meaning of specific provisions in the regulation.

43. Consequently rather than relying upon extrinsic non-legislative or regulatory sources, the Committee in considering the appropriate meaning to be derived from the words used in the regulation, and consistent with the principles of statutory interpretation, looked to the words used, both in the specific context that they were used, and in the context of the overall scheme of the regulation, together with regulatory pronouncements specifically relating to the Projects which defined their nature and scope. The Committee has also considered the Alberta Oil Sands Royalty Regulation Guidelines recognizing that while such guidelines must be consistent with the Act and regulations, they also provide useful information as to what costs Alberta Energy considered could be allowed or disallowed within the regulation.

44. In that context the Committee considers that the royalty scheme adopted in OSRR-97 which provides for an exceedingly modest gross royalty (1%) minimum royalty

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11 The objectives of the royalty regime were addressed in the Alberta Oil Sands Royalty Guidelines, Principles and Procedures, February 2, 2001 in section 1.2.2. The first objective listed was “to optimize the sustained contribution from Alberta’s resources in the interest of Albertans”.

12 For example Ministerial Order 51/2005

combined with a net profits interest royalty which precludes any such payment until costs of development are recovered by the project owner, in order to encourage the development of this higher risk capital intensive activity, is also intended to protect the Crown’s ownership rights to a reasonable rental for the resource being exploited. The method the regulation uses to accomplish these purposes is through the net profits interest royalty which restricts the costs that are allowed for the purpose of royalty calculation. Too broad or too narrow an interpretation of the allowed cost provisions would not achieve the balance intended by the regulation.

45. The scheme set up in sections 2 and 3 of Schedule 1 is to define both the costs that are allowed and the costs that are disallowed. Section 2 of the Schedule sets out five criteria, each of which must be met before a cost is considered an allowed cost of the Projects for the purposes of royalty calculations.

46. The two subsections which were the focus of debate before the Committee were subsections (a) and (e). In that regard the Committee did not find that the case law cited by the parties provided much assistance in the interpretation of those subsections.

47. With respect to subsection (a) the Committee considers that the Suncor interpretation is overly broad and the Department’s interpretation is unduly narrow. The Committee considers that having regard to the intention of the regulation and words used that “directly attributable” require a connection but not a sole connection to the project. That interpretation is supported by the dictionary definitions provided by Suncor in its submissions.

48. Whether a cost is directly attributable as required by subsection (a) is also dependent on what constitutes the activities of the Project. The Committee considers that the Project Approval Order which defines the activities of the Project in section 3, sets out relevant parameters against which the claimed costs may be measured for the purpose of determining whether they are allowed costs.

49. With respect to subsection (e), the Committee considers that the meaning of “incurred to” (which dictionaries define as “expended”) is restricted by and to the activities listed in that subsection, and that there must be a necessary causal connection to one of those activities in order to qualify as an allowed cost. Moreover the Committee is of the view that in determining the type of costs that are allowed under section 2, it is necessary to consider the whole of the Schedule including section 3 which sets out costs that will not be allowed and that it is appropriate to use the illustrative Table included at the end of the Regulation. That not every cost expended by the project owner is recoverable is clear as otherwise there would not be the five criteria set out in section 2. In other words it is not sufficient to say that if it is not disallowed under section 3, it must be an allowed cost.

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11 The costs must be directly attributable to the Project, must be reasonable in the circumstances, must be incurred by or on behalf of the Project owner, must be incurred after the effective date of the Project and before December 2008, and must be incurred to accomplish the activities listed in subsection (e).

12 Paragraph 3 i

23 Ministerial Order 51/2005
under section 2. More is required to gain the benefit of section 2's allowed cost determination. However, the effect of Suncor's argument is exactly that. On the other hand the effect of the Department's interpretation is to effectively ignore the very specific regulatory description of the Project contained in Ministerial Order 51/2005.

50. Therefore in applying subsection (e) the Committee is of the view that for a cost to meet that criterion it must have been expended for the purposes set out in that subsection and not for other purposes. Further the Committee is of the view that there is an element of necessity associated with the costs. The illustrative Table contained in the Schedule, uses terms such as "direct" and "necessary". In the Committee's view those terms are indicative of an intention that an allowed cost must be necessary for the purpose of the activities set out in subsection (e). The Committee rejects the expansive interpretation of subsection (e) of section 2 argued by Suncor.

51. Finally it is clear that overhead, administrative, and other indirect costs are not generally considered to be allowed costs. Subsection 3(a) specifically excludes such costs except if they are allowed under subsection (x) of section 2(e). Section 2(e)(x) restricts the recovery of such costs to those related to some of the activities listed in section 2(e).24

52. A further issue of interpretation that must be dealt with is the inter-relationship between section 2 and 3 of the Schedule. Suncor argues that section 3 provides for exceptions from section 2 and therefore must be strictly interpreted against the party relying upon such exceptions. The Department argues that these are not true exceptions in the sense contemplated by authorities that require a strict and limiting interpretation, but rather sections 2 and 3 read together produce a list of allowed and a list of disallowed costs. The fact that a cost is not specifically disallowed in section 3 does not by definition make it an allowed cost in section 2. All of the criteria contained in section 2 must be met whether or not the cost is listed as a disallowed cost in section 3.

53. The Committee notes that this issue of interpretation in this case only relates to section 3(a) relating to overhead and administrative expenses. Suncor essentially says that the clause must be interpreted very narrowly so that only those kind of overhead and administrative expenses specifically listed or similar to those specifically listed are disallowed. The Department says that by using the word "including" in section 3(a), such subsection was clearly not intended to be restrictive, but in any event the clause must be interpreted as a broad exclusion of overhead with respect to claimed costs, as it specifically included an exception to such a broad exclusion by reference to section 2(e)(x) which allowed overhead, field and administrative expenses only in relation to some of the listed activities in section 2.

54. Without deciding the broader issue of the inter-relationship between sections 2 and 3, the Committee is of the view that the disallowance in section 3(a) is broad in nature, given

24 The Royalty Guidelines, February 2, 2001 provide an illustration of this direct connection with respect to R & D costs. Recoverable R and D costs pursuant to those guidelines must have a "specific practical application to the project" and be "related directly to activities with in the project" (section 4.1, p. 27). See also Appendix 3 which is an expansion of the Table in the regulation.
the inclusion of the exception which would not have been necessary if the exclusion was narrowly interpreted.

55. Before addressing the specific cost disallowances the Committee also wishes to address the criterion of reasonableness set out in paragraph 2(b). This criterion was not the subject of any extensive discussion by the parties, but the Department did note that it regards this as an assessment of the quantum involved. The Committee suggests that that criterion is broader than a quantum criterion and can extend to whether it was reasonable to expend that money at all.

56. The Committee applying these general principles of interpretation considered each of the categories of disallowed costs for the purpose of making recommendations respecting Suncor’s appeal. The Committee did not undertake a line by line analysis of each of the disallowed costs set out on Schedules 1, 2, and 3 to this report as it did not have sufficient information to conduct such an analysis for the reasons set out in paragraph 25 of this Report. But it has used the Suncor categorization of the costs as a basis for its general analysis. However, in reaching general conclusions as to the eligibility of those costs to be considered as allowed costs, the fact that the Committee may be of the view that the specific category of costs as identified by Suncor is an allowed cost is not a recommendation that each cost included in that category as set out in the attached schedules is recoverable as the specific cost may or may not actually meet the description of the category and the Committee has insufficient information to make that determination.

Specific Cost categories

57. The Committee considered each of the cost categories\(^{35}\) that Suncor argues ought to be allowed and has reached the following conclusions.

Category 1 – Mitigation and consultation funding to First Nations/Metis entities affected by Project 047 or 050
Category 3 – Good Neighbour funding to the communities affected by or proximate to Project 047 or 050

58. With respect to Category 1 and 3 costs, Suncor argued that the costs were directly attributable to the project and incurred for the purpose of recovering oil sands from the development areas of the Projects, and as there were no issues raised under the other criteria, all such costs should be allowed. The Department argued that these were voluntary expenditures not required for the recovery of oil sands.

59. Suncor’s submission was largely based upon its assertion that such costs were a required expenditure to satisfy its obligations pursuant to ERCB Information Letter IL 89-4 and the Department’s opposition was based on its view that if the costs were not expended

\(^{35}\) Set out in paragraph 26 of this Report
pursuant to a condition in the ERCB permit they were voluntarily expended for some other purpose such as corporate good will and not for the purpose of recovering oil sands.

60. The Committee, having regard to its conclusions as to the proper interpretation of section 2 and the evidence before it, is of the opinion that some of the costs included in the two categories referred to would satisfy the requirements of section 2 and are allowed costs. As noted above however it has insufficient information to determine whether any of the specific disallowed costs would qualify as allowed costs.

61. The Committee’s view is that the following costs would qualify under section 2:

(a) costs that were expended post approval to comply with commitments made to stakeholders including aboriginal and Metis groups and the affected community during the approval process for the Projects, whether made in writing or orally during the approval process, or whether made formally during the hearing process or referred to in the application material, and which commitments were relied upon by those stakeholders in making representations respecting the Projects;

(b) costs that were expended to carry out community communication and consultation activities after the project approval respecting the projects and any issues arising from the Projects;

(c) costs that were expended to make any changes to the Projects to address any issues raised through the consultation process.

62. The Committee reaches its conclusion for the following reasons:

(a) In its opinion all of the above noted costs – and likely most of the costs claimed in those categories by Suncor in the attached schedules – are directly attributable to the Projects as that term is used in section 2(a). This is supported by Schedule A, section 3 of Ministerial Order 51/2005 where operations of the Project are stated to include “operations incidental to and supporting the Suncor Oil Sands Project to address regulatory and environmental requirements and issues, including reclamation and emissions”;

(b) In its opinion, the costs described in paragraph 61 are consistent with the expectations of the ERCB set out Information Letter IL 89-4 and necessary to ensure the maintenance of the permit for the recovery of oil sands, given the ERCB’s retained discretion to rescind or amend the permit set out in paragraph 16 of the ERCB permit and the powers conferred on the ERCB under the Oilsands Conservation Act.

63. The Committee is further of the view that costs expended on a voluntary basis for corporate good will and which do not meet the criteria set out in paragraph 63 are not allowed costs within the meaning of section 2 of Schedule 1 of OSRR-97 and are

 FN 16

Page 15 of 25
properly disallowed. This may include the bulk of the claimed charitable donations, but the Committee has insufficient information to determine this and make recommendations.

The Committee therefore recommends that:

(a) to the extent that costs included in Suncor's categories 1 and 3 meet the following criteria that such costs are allowed costs within the meaning of section 2 of Schedule 1 of OSSR-97:

(i) costs that were expended post approval to comply with commitments made to stakeholders including aboriginal and Metis groups and the affected community during the approval process for the Projects, whether made in writing or orally during the approval process, or whether made formally during the hearing process or referred to in the application material, and which commitments were relied upon by those stakeholders in making representations respecting the Projects;

(ii) costs that were expended to carry out community communication and consultation activities after the project approval respecting the projects and any issues arising from the Projects; and

(iii) costs that were expended to make any changes to the Projects to address any issues raised through the consultation process.

(b) Costs included in Suncor's categories 1 and 3 that do not meet that criteria are disallowed.

Category 2 – Payment to facilitate First Nation/Metis employment at Project 047 or 050

64. Suncor advised that this category consisted of costs necessary to fly in and fly out aboriginal employees who worked on the Projects consistent with commitments given to First Nations stakeholders.

65. The Committee is of the view that these costs are allowed costs within the meaning of section 2 of Schedule 1 of OSSR-97.

66. The Committee reaches its conclusions for the following reasons:

(a) the costs are directly attributable to the Projects and are incurred for the purpose of recovering oil sands, all as contemplated in section 2 of Schedule 1;
(b) labour costs necessary for the operation of the Projects are recognized as allowed costs in the Table at the end of the Regulation;

(c) Travel is recognized as an allowed labour cost in Appendix 3 of the Oil Sands Royalty Regulation Guidelines.

67. To the extent that costs shown as Category 2 costs on the attached schedules are in fact travel costs for workers, the Committee considers that they are in compliance with section 2 of Schedule 1. The Committee notes however that there may be costs in the attached schedules which are described as Category 2 costs which may in fact not be such costs. The Committee has insufficient information to identify whether that is the case.

The Committee therefore recommends that, to the extent that the costs contained in Suncor's category 2 are costs expended to transport aboriginal workers to and from the Projects worksite by air, those costs are allowed costs.

Category 4 – Mitigation funding to regional groups working on the impacts of the Projects

68. The costs claimed in this category are contributions to two regional working groups, namely, the Regional Infrastructure Working Group and the Cumulative Environmental Management Agency, which are multi-party organizations dealing with regional and environmental impacts of the various developments in Wood Buffalo area.

69. The committee is of the view that these costs are not allowed costs as defined by section 2 of Schedule 1 of OSRR-97.

70. The Committee reaches this conclusion on the basis that these costs are not directly attributable to the Projects as that term is defined in section 2 of Schedule 1. These working groups were organized to deal with the impacts of multiple developments and not simply the Projects and have only an indirect connection to each Project.

The Committee therefore recommends that costs contained in Suncor's category 4 be disallowed.

Category 5 – Payments for the benefit of Suncor employees

71. This category involves a number of expenditures on items for the benefit of Suncor employees. The Department says that these are not necessary expenditures, as they are
not required in a Union or other employment contract and are not tied to any performance expectations.

72. The Committee is of the view that these expenditures meet the requirements of section 2 of Schedule 1 of OSRR-97.

73. It reaches this conclusion for the following reasons:

(a) The expenditures are with respect to employees employed in the operations of the Projects and therefore are directly attributable to the Projects;

(b) They are part of labour expenses broadly defined. In that regard the Committee takes note of the fact that it is reasonably well known that obtaining and retaining employees for these Projects has over the years been a challenge for the project owner. Non financial rewards in the form of items that express appreciation to the employees in a variety of circumstances are in the opinion of the Committee a reasonable expenditure for the purpose of fostering employee loyalty. Keeping employees is clearly necessary for carrying out the activities described in section 2.

74. The Committee notes that its conclusion is based on whether the expenditures fit within subsections (a) and (e) of section 2. It reaches no conclusions with respect to whether each of the expenditures shown in that category is in compliance with subsection (b) of section 2 as it has insufficient information to reach that conclusion.

The Committee therefore recommends that the costs in Suncor’s category 5 are allowed costs pursuant to section 2 of Schedule 1 of the regulation provided that such costs are reasonable in the circumstances.

Category 6 – Payments for community celebration related to Project opening

75. Suncor claims all of the costs related to the official opening of the Millenium project.

76. The Committee is of the view that while all of the costs meet the criterion set out in subsection (a) of section 2 of Schedule 1 of OSRR-97, that not all of the costs meet the criterion set out in subsection (e).

77. The Committee is of this view because the costs of such celebration are in its view only recoverable as an allowed cost to the extent that the expenditure was in furtherance of the ERCB’s expectation in IL 89-4. The Committee has no information as to the involvement of the community but observes that a significant amount was expended on this event which in its view may be perfectly appropriate for Suncor in furtherance of its
corporate objectives but is in excess of what was necessary to meet the ERCB’s expectations.

The Committee therefore recommends that only a portion of the expenses related to the Millenium opening be considered an allowed cost, such portion to be determined by a consideration of the ERCB expectation and the actual community involvement in such opening.

Category 7 – General Suncor operating expense related to the Projects
Category 8 – Payment to facilitate Suncor’s participation in general industry related projects

78. Very few of the costs claimed by Suncor fall into the two above categories, which appear to be catchall categories to capture costs which cannot be precisely identified with activities of the Project.

79. The Committee has looked at each of the costs claimed and is not satisfied that Suncor has presented any justification that supports inclusion of these costs on any basis as allowed costs pursuant to section 2 of Schedule 2 of OSSR-97.

80. In particular Suncor has not shown that these costs are attributable to the Projects or that they were incurred in connection with any of the activities listed in section 2(e).

The Committee recommends that all of the costs in Suncor’s categories 7 and 8 be disallowed.

V. CONCLUSION

81. In conclusion, the Committee makes the following recommendations to the Minister:

(a) That for the purpose of calculating the cost of service of the pipeline the UCC is $200 million, being the net book value according to the records of the Department, and that Suncor’s appeal of this determination be rejected.

(b) To the extent that costs included in Suncor’s categories 1 and 3 meet the following criteria that such costs are allowed costs within the meaning of section 2 of Schedule 1 of OSSR-97:

(i) costs that were expended post approval to comply with commitments made to stakeholders including aboriginal and Metis groups and the
affected community during the approval process for the Projects, whether made in writing or orally during the approval process, or whether made formally during the hearing process or referred to in the application material, and which commitments were relied upon by those stakeholders in making representations respecting the Project;

(ii) costs that were expended to carry out community communication and consultation activities after the project approval respecting the projects and any issues arising from the Projects; and

(iii) Costs that were expended to make any changes to the Projects to address issues raised through the consultation process.

(c) That costs included in Suncor’s categories 1 and 3 that do not meet the above criteria are disallowed.

(d) That to the extent that the costs contained in Suncor’s category 2 are costs expended to transport aboriginal workers to and from the worksite by air those costs are allowed costs.

(e) That costs contained in Suncor’s category 4 be disallowed.

(f) That the costs in Suncor’s category 5 are allowed costs pursuant to section 2 of Schedule 1 of the regulation provided that such costs are reasonable in the circumstances.

(g) That only a portion of the expenses related to the Millenium opening be considered an allowed cost, such portion to be determined by a consideration of the ERCB expectation and the actual community involvement in such opening.

(h) That all of the costs in Suncor’s categories 7 and 8 be disallowed.

All of which is respectfully submitted this __ day of November, 2009.

Phyllis Smith, Q.C., Chair

Peter Taschuk, Q.C., Member

David Tavender, Q.C., Member
affected community during the approval process for the Projects, whether made in writing or orally during the approval process, or whether made formally during the hearing process or referred to in the application material, and which commitments were relied upon by those stakeholders in making representations respecting the Projects;

(ii) costs that were expended to carry out community communication and consultation activities after the project approval respecting the projects and any issues arising from the Projects; and

(iii) Costs that were expended to make any changes to the Projects to address issues raised through the consultation process.

(c) That costs included in Suncor's categories 1 and 3 that do not meet the above criteria are disallowed.

(d) That to the extent that the costs contained in Suncor's category 2 are costs expended to transport aboriginal workers to and from the worksite by air those costs are allowed costs.

(e) That costs contained in Suncor's category 4 be disallowed.

(f) That the costs in Suncor's category 5 are allowed costs pursuant to section 2 of Schedule 1 of the regulation provided that such costs are reasonable in the circumstances.

(g) That only a portion of the expenses related to the Millenium opening be considered an allowed cost, such portion to be determined by a consideration of the ERCB expectation and the actual community involvement in such opening.

(h) That all of the costs in Suncor's categories 7 and 8 be disallowed.

All of which is respectfully submitted this ___ day of November, 2009.

Phyllis Smith, Q.C., Chair

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(ii) costs that were expended to carry out community communication and consultation activities after the project approval respecting the projects and any issues arising from the Projects; and

(iii) Costs that were expended to make any changes to the Projects to address issues raised through the consultation process.

(c) That costs included in Suncor's categories 1 and 3 that do not meet the above criteria are disallowed.

(d) That to the extent that the costs contained in Suncor's category 2 are costs expended to transport aboriginal workers to and from the worksite by air those costs are allowed costs.

(e) That costs contained in Suncor's category 4 be disallowed.

(f) That the costs in Suncor's category 5 are allowed costs pursuant to section 2 of Schedule 1 of the regulation provided that such costs are reasonable in the circumstances.

(g) That only a portion of the expenses related to the Millenium opening be considered an allowed cost, such portion to be determined by a consideration of the ERCB expectation and the actual community involvement in such opening.

(h) That all of the costs in Suncor's categories 7 and 8 be disallowed.

All of which is respectfully submitted this ___ day of November, 2009.

Phyllis Smith, Q.C., Chair

Peter Taschuk, Q.C., Member

David Tavender, Q.C., Member
Appendix "B" – Minister’s Decision

GOVERNMENT OF ALBERTA
DEPARTMENT OF ENERGY

MINISTERIAL ORDER 32/2010

I, RON LIEPERT, Minister of Energy, pursuant to section 10(2) of the Oil Sands Dispute Resolution Regulation (AR 247/2007), section 35 of the Oil Sands Royalty Regulation, 1997 (185/97) and sections 8(3) and 39 of the Mines and Minerals Act, R.S.A. 2000, c. M-17, make the Order in the attached Appendix, being the Suncor Oil Sands Dispute Review Committee Decision Order.

DATED the 24th day of March, 2010.

[Signature]
Minister of Energy
APPENDIX

SUNCOR OIL SANDS DISPUTE REVIEW COMMITTEE DECISION ORDER

1. The recommendations, reasons and general principles of legislative interpretation of the Suncor Oil Sands Dispute Review Committee (the “Committee”), established by Ministerial Order 20/2009 to hear Oil Sands Royalty Regulation, 1997 matters in dispute between the Department of Energy (the “Department”) and Suncor Energy Inc. (“Suncor”) concerning the Department’s royalty audit assessments for the Suncor Oil Sands Project approved pursuant to Project Approval Order No. OSR047 (production years 2001, 2002 & 2003) and for the Firebag Project approved pursuant to Project Approval Order No. OSR050 (production years 2002 & 2003), as provided in its report dated November 4, 2009 (the “Report”) are accepted.

2. Paragraph 63 of the Report is corrected by striking out “paragraph 63” and substituting “paragraph 61”.

3. Pursuant to paragraph 25 of the Committee Report and subject to paragraph 4 of this Appendix, the Department shall apply the principles of legislative interpretation and such other criteria as provided in the Committee Report to cost categories 1, 2, 3, 5 and 6 on a line-by-line cost basis and issue a decision on each cost to Suncor and the Department’s Director of Dispute Resolution within 90 days of the date of this Order, or such other period of time as agreed to by the parties.

4. In order to be accepted as an allowed cost, a cost expended post approval to comply with commitments made to stakeholders, as referred to in paragraph 61(a) of the Report, must meet the following evidentiary requirement: there must be a specific reference in an Energy Resources Conservation Board (“ERCB”) approval or decision report that confirms that the commitments for which the costs were incurred were relied upon by stakeholders in making representations to the ERCB. The onus of meeting this evidentiary requirement rests with Suncor, and Suncor shall submit such evidence to the Department within 30 days of the date of this Order, or such other period of time as agreed to by the parties.

5. The Department shall request any additional specific information necessary to make a decision under paragraph 3 of this Appendix within 30 days of the date of this Order, or such other period of time as agreed to by the parties.

6. Suncor shall submit information requested under paragraph 5 of this Appendix to the Department within 60 days of the date of this Order, or such other period of time as agreed to by the parties.

7. If Suncor does not submit the requested information under paragraph 5 of this Appendix within the stated or agreed to period of time, the Department may disallow any cost associated with that information.

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8. Suncor may appeal a decision made by the Department under paragraph 3 of this Appendix to the Director of Dispute Resolution or to such other entity as may be agreed to by the Minister of Energy and Suncor (the “Appeal Body”). The appeal must be made in writing and received by the Director or the Appeal Body within 7 days of the date of the decision.

9. The Director of Dispute Resolution or Appeal Body, upon receiving an appeal request under paragraph 8 of this Appendix, shall conduct the appeal and issue a final decision on each cost within 30 days of receiving the request, or such other period of time as agreed to by the parties.

10. At the conclusion of an appeal, if any, conducted under paragraph 9 of this Appendix, the Department shall make recalculations under section 39(2) of the Mines and Minerals Act in respect to cost decisions made under this Appendix, as applicable.

11. Cost decisions made by the Director of Dispute Resolution or the Appeal Body under paragraph 9 of this Appendix are final and may not be further appealed.