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OIL SANDS OPERATIONS BULLETIN 2009-02

SUBJECT: REPORTING AND PAYMENT OF ROYALTIES ON PRE-2009 INVENTORY VOLUMES

Effective January 1, 2009, section 53 of the *Oil Sands Royalty Regulation, 2009* authorized a number of consequential amendments to the *Oil Sands Royalty Regulation, 1997*, in particular those dealing with the reporting and payment of royalties on pre-2009 inventory volumes. The Department previously laid out the requirements for an inventory statement in IB 2008-02; this Information Bulletin deals with the valuation and payment of royalty on those inventories. All oil sands Projects, other than the Syncrude and Suncor Projects, having any production on or before December 2008 will be affected by these consequential amendments.

What are Pre-2009 Inventories?

Under section 38.1 of the *Oil Sands Royalty Regulation, 1997*, any oil sands product that is obtained pursuant to a Project and delivered at a royalty calculation point for the product before January 1, 2009, and is not disposed of, consumed or used before that date, is along with the Crown's royalty share of the oil sands product, deemed to be disposed of during December 2008. Section 38.1 applies to such things as pipeline fill volumes or oil sands product in storage.

- "Oil sands products" include cleaned crude bitumen, blended crude bitumen, sulphur or any other oil sands product.
- "Obtained pursuant to a Project," means oil sands products recovered pursuant to the Project. This includes oil sands products obtained pursuant to the Project from feedstock obtained other than from the development area of the Project, i.e., "purchased feedstock" (as other net proceeds).
- The royalty calculation point for an oil sands product is the applicable royalty calculation point for that product under section 23 of the *Oil Sands Royalty Regulation, 1997*.
    - For crude bitumen, this is the last point of measurement before delivery from the Project from which the product is recovered if the product is then permanently removed from the Project.
    - For cleaned crude bitumen, it is the last point of measurement before the cleaned crude bitumen obtained from the Project is delivered from the processing plant (e.g., a cleaning plant) at which it is obtained.
- Section 38.1 applies to all oil sands products passing a royalty calculation point before January 1, 2009, i.e., up to midnight on December 31, 2008. Any production from midnight on December 31, 2008 to 8:00 am on January 1, 2009 will be considered as oil

sands product for the Project subject to royalty for the January reporting month or 2009 reporting Period, under the *Oil Sands Royalty Regulation, 2009*.
- The oil sands product must not have already been disposed of, consumed or used by January 1, 2009, e.g., it must be either in transit or in storage.
- The deeming of dispositions during December 2008 triggers royalty reporting of inventory volumes as December 2008 dispositions, with the applicable penalties for failure to report on time.
- The handling charges that will be allowed in the calculation of unit price are those that apply in relation to any third party dispositions taken into account under section 32(2), 32(3) or 32(5) of the *Oil Sands Royalty Regulation, 2009*. If there are no sales in a month of an oil sands product, e.g., sulphur or asphalt, the unit price for that month for that product will be calculated using the price determined by the Minister as the fair market value for that oil sands product, under section 32(6) of th*e Oil Sands Royalty Regulation, 2009*.

When Must the Proceeds of Disposition for the Deemed Sale of the Inventory Volumes Need To Be Paid?

Under section 31 of the *Oil Sands Royalty Regulation, 1997*, the proceeds of disposition of the Crown's royalty share are normally payable before the end of the month following the month in which the oil sands product is disposed of, used or consumed. By virtue of section 38.1, the operator of a Project has until April 30, 2010 to pay to the Crown the proceeds of the (deemed) disposition of the Crown's royalty share of an oil sands product. Section 38.1 also overrides the post-payout estimated instalment requirement of that section as well as the regular payment due dates of that section.

- Payments are lump sum and cannot be made in instalments.
- Operators have over a year to plan for their payments. The normal interest and penalty provisions under the *Oil Sands Royalty Regulation, 1997* will not apply unless payment is not made by April 30, 2010, as per section 38.1(3).
- Operators may choose to make their payments before April 30, 2010, but no earlier than January 2010, because of the way unit prices for the (deemed) disposition are calculated. See next section below.
- These payments will be treated as payments under the *Oil Sands Royalty Regulation, 1997* for the December 2008 reporting month. Payments must also be reported on the 2008 End of Period Statements for each Project, but since the unit prices will not be known until the end of 2009, the 2008 End of Period Statements will need to be amended.

What Unit Price Applies to Pre-2009 Inventory?

Under section 21 of the *Oil Sands Royalty Regulation, 1997*, the unit price that normally applies in a month of a pre-payout Project or a Period for a post-payout project will be determined based on the total consideration, handling charges and total dispositions of the oil sands product during that period. By virtue of section 38.1(2), the unit price applicable to the Pre-2009 inventory of an oil sands product is the simple average of the unit prices that would be determined under section 32 of the *Oil Sands Royalty Regulation, 2009* for each month of 2009, and would apply to an oil sands product of that kind obtained pursuant to the Project and delivered at a royalty calculation point under that regulation for the product during those months, if those months were part of a pre-payout Period of the Project.

- Rather than applying a unit price taken from only one month, and in order to accommodate post-payout Projects that use an annual unit price, the unit price applicable will be calculated over all the months of the 2009 calendar year.
- Operators will determine unit prices for their oil sands products for each month in 2009 as per section 32 of the *Oil Sands Royalty Regulation, 2009*.
  - The volumes of each oil sands product crossing the royalty calculation point for a Project in a month will be valued based on the third party dispositions for that oil sands product in that month.
  - If third party dispositions in that month fall below the third party disposition threshold (40%), section 32(4) will apply.
- Despite a Project being in post-payout, the unit price applicable to valuation of the pre-2009 inventory will be determined on a monthly basis rather than on a yearly basis, as would normally be the case. Refer to sections 32(2) and 32(4) of the *Oil Sands Royalty Regulation, 2009*.

What is the Impact of Reporting and Payment of Pre-2009 Inventories on a Project?

The disposition of inventory volumes in 2008 will apply to the royalty calculations (e.g., Gross Revenue, Net Revenue, Project Revenue, and cumulative costs) in 2008 and carry through 2009.

- The (deemed) dispositions of inventory volumes will be reported in the statements for December 2008 (for pre-Payout) and the 2008 Period (for post-payout), under the *Oil Sands Royalty Regulation, 1997*.
- End of Period Statements for each Project for 2008 will also report these dispositions, under the *Oil Sands Royalty Regulation, 1997*. The value for these dispositions - and hence the gross and net revenues, and cumulative costs - will not be known until the end of 2009.
- Revised End of Period Statements for 2008 will need to be filed once the unit price and proceeds of disposition are known, with the filing of the End of Period Report for 2009, under the *Oil Sands Royalty Regulation, 2009*. A revised monthly statement for December 2008 should also be filed, in accordance with the *Oil Sands Royalty Regulation, 1997*.
- Good Faith Estimates for 2008 may also be affected: the (deemed) dispositions in December 2008 may change the net revenue/net loss of post-payout Projects in 2008 and beyond.

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