June 26, 2019

Royalty Certainty for the Oil and Gas Industry?

By: Nigel Bankes

Legislation Commented On: Alberta Bill 12: Royalty Guarantee Act

On June 20, 2019 Alberta's Legislature gave first reading to Bill 12, The Royalty Guarantee Act. The Bill aims to fulfil a commitment made as part of the United Conservative Party's (UCP) election platform:

> Royalty Guarantee
>
> Recent Alberta governments shook investor confidence with royalty reviews. A United Conservative government will guarantee in law that the royalty regime in place when a well is permitted will remain in place for that project in perpetuity. (at 30)

In the press release accompanying introduction of the Bill, Minister Sonya Savage reiterated the concerns that led to its introduction:

> Frequent royalty reviews have had a significant negative impact on the energy industry and our province's ability to compete with other energy jurisdictions. Alberta has competitive royalty rates and investors need certainty when making long-term decisions that the rates will not change on a whim. This legislation would provide the guarantee that stability isn't just something we talk about in Alberta, it is the law.

This post examines the current rules in relation to changes in Crown royalties and then considers the scope and effect of Bill 12.

The Current Rules

Put simply, the current rules do not provide any legal guarantee of royalty stability. This is a long-standing policy position of successive governments in Alberta. It does not mean that royalties have been changed "on a whim", but it does mean that the Government is legally free to alter the royalty regime for Crown owned mines and minerals as it sees fit in the public interest. The legal vehicle for giving effect to this policy is the combination of section 34 of the *Mines and Minerals Act*, RSA 2000, c M-17 (*MMA*) and the language of the standard licence and lease form that the province has adopted. Section 34 of the *MMA* provides as follows:

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

The term "agreement" in the *MMA* simply means any instrument that grants rights with respect to minerals or the subsurface. It therefore includes licences and leases with respect to petroleum and natural gas.

The current petroleum and natural gas lease form provides, so far as relevant, as follows (and the current licence form is essentially identical):

> WHEREAS Her Majesty is the owner of the minerals in respect of which rights are granted under this Lease;
>
> THEREFORE, subject to the terms and conditions of this Lease, Her Majesty grants to the Lessee, insofar as Her Majesty has the right to grant the same, the exclusive right to drill for and recover the Leased Substances within the Location, together with the right to remove from the Location any Leased Substances recovered, for the term of five years computed from the Term Commencement Date and, subject to the *Mines and Minerals Act*, for so long after the expiration of that term as this Lease is permitted to continue under that Act.
>
> RESERVING AND PAYING to Her Majesty,
>
> (a) in respect of each year during which this Lease remains in effect, a clear yearly rental computed at the rate prescribed by, and payable in accordance with, the *Mines and Minerals Act*, and
>
> (b) the royalty on all Leased Substances recovered pursuant to this Lease, that is now or may hereafter from time to time be prescribed by, and that is payable in accordance with, the *Mines and Minerals Act*, such royalty to be calculated free of any deductions except those that are permitted under the *Mines and Minerals Act.*
>
> 1(1) In this Lease, a reference to the *Mines and Minerals Act* or to any other Act of the Legislature of Alberta referred to in section 2(2)(b) of this Lease shall be construed as a reference to
>
> (a) that Act, as amended from time to time,
>
> (b) any replacement of all or part of that Act from time to time enacted by the Legislature, as amended from time to time, and
>
> (c) any regulations, orders, directives or other subordinate legislation from time to time made under any enactment referred to in clause (a) or (b), as amended from time to time.
>
> (emphasis added)

As a matter of law therefore – whether viewed in terms of contract, property or administrative law – the Government is free to change the applicable royalty from time to time and these changes are incorporated automatically into the terms of existing Crown licenses and leases. In

sum, there is no grandparenting of rights and no entitlement on the part of the lessee to insist that the level of royalty that is payable is the royalty that prevailed when the lease or licence was acquired. Crown lessees and licensees knowingly purchase Crown mineral rights at bonus bid sales on this understanding.

Bill 12

Bill 12 takes the form of three amendments to the *Mines and Minerals Act*. The first amendment is to section 34 quoted above and simply provides that that section applies *subject to the new section 34.1*. The second amendment is the addition of section 34.1, the elements of which are described below under three headings: (1) what is covered by the new amendment"; (2) what is the scope of the guarantee(s); and (3) what is the definition of fundamental restructuring. The third amendment is an amendment to section 36 to provide the Lieutenant Governor in Council with new regulation making powers in relation to the new section 34.1.

What is Covered by the Guarantee?

Bill 12 applies to "hydrocarbon royalties". While the Bill does not define "hydrocarbon" it does specify that for the purpose of the guarantee "hydrocarbon does not include coal". Beyond that the term has its ordinary meaning and therefore includes not only petroleum and natural gas, but also oil sands.

What is the Scope of the Guarantee(s)

Bill 12 contains two guarantees.

The first guarantee is that for a period of ten years following the entry into force of the Bill:

> … no fundamental restructuring of the legislative framework generally applicable to hydrocarbon royalties reserved to the Crown in right of Alberta shall be implemented.

The passive voice cannot hide the fact that this represents a commitment that neither the legislature nor the executive will "implement" a significant royalty change for ten years (I discuss below the definition of fundamental restructuring). The guarantee is *functus* after ten years unless it is renewed.

The second guarantee is that "subject to the regulations":

> … no fundamental restructuring of the legislative framework applicable to hydrocarbon royalties reserved to the Crown in right of Alberta in place on the date a well commences production shall be implemented with respect to that well for a period of 10 years after that date.

Unlike the first guarantee this guarantee is constantly speaking unless and until it is repealed. It is a well-by-well guarantee. It is not a guarantee that the province's royalty scheme will never change, but it is a guarantee that the royalty for each well will not change for a 10 year period

measured from when that well starts to produce. This is not therefore a law (as per the UCP platform) that guarantees "that the royalty regime in place when a well is permitted will remain in place for that project in perpetuity." (emphasis added)

What is the Definition of Fundamental Restructuring?

Bill 12 does not define what "fundamental restructuring" means, but it does define what it does *not* include. In particular, it does not include adjustments or changes made:

(i) to simplify or streamline cost calculations, processes, reporting or other similar requirements of an enactment or policy,
(ii) to address significant changes in technology and world markets,
(iii) in accordance with an enactment in force on the date this section comes into force, except as otherwise provided in this section, or in accordance with a relevant policy, including the planned transition to the Modernized Royalty Framework, 2017, or
(iv) where the Government of Alberta considers that the adjustments or changes are appropriate and consistent with this section.

Paragraph (i) seems straightforward, although one person's simplification of a cost calculation may be another person's disallowance (see the two recent oil sands royalty cases that have come before the courts: *Cenovus TL ULC v Alberta (Energy)*, 2019 ABQB 301 (CanLII), and *Fort Hills Energy Corporation v Alberta (Minister of Energy)*, 2018 ABQB 905 (CanLII)).

Paragraph (ii) significantly limits the value of both guarantees since its effect is to *allow* fundamental restructuring whenever more rents are available as a result of declining cost inputs due to technological developments or (assuming that the 'and' in this phrase is disjunctive and not conjunctive or cumulative) changes in world prices. These are precisely the circumstances in which governments are most tempted to make changes (and perhaps even if the royalty structure is already, as many are or should be, cost and price sensitive). What this legislation pretty much guarantees however is that any attempt by a government to rely on either of these exceptions will be litigated.

Paragraph (iii) is a bit of a mouthful. It seems to establish two additional exceptions to what might otherwise be a fundamental restructuring. Thus, an adjustment or change will not count as a fundamental restructuring if the adjustment or change is: (1) [A] in accordance with an enactment in force on the date this section comes into force, [B] except as otherwise provided in this section, or (2) in accordance with a relevant policy, including the planned transition to the Modernized Royalty Framework, 2017.

The first part of the first exception ([A]) runs the risk of dismantling any guarantee since, as noted above, the *MMA* (in force when this amendment enters into force) does itself permit adjustments and changes. Hence the second part of the clause ([B]) "except as otherwise provided in this section" which presumably serves to give primacy to this amendment. But that still begs the question of just what discretionary changes and adjustments this first exception was designed to protect.

The second part of this exception permits changes or adjustments "in accordance with a relevant policy". Grammatically, this phrase is not confined to a policy "that is in force on the date this section comes into force". That qualification only applies to enactments, and under section 28(1)(m) of the *Interpretation Act*, RSA 2000, c I-8, "enactment" means "an Act or a regulation or any portion of an Act or regulation". Perhaps this is a drafting error. It certainly seems strange to allow *future* policies to determine the ambit of legislation, especially legislation designed to confer a guarantee. The reference to the Modernized Royalty Framework, 2017 is a reference to the royalty policy put in place by the Notley Government.

Paragraph (iv) is also pretty much a guarantee of litigation. It contemplates that the Government of Alberta may effectively deem an adjustment or change not to amount to fundamental restructuring, provided that it considers the adjustment or change to be "appropriate". However, the Government can only do so where such a deeming would be "consistent with this section". I have no idea what this qualification means.

The Regulation Making Power

Section 36 of the *MMA* will be amended to provide the Lieutenant Governor in Council with the power to make regulations with respect to the following:

> (i) defining any word or expression used but not defined in clauses (g) and (h) and section 34.1;
>
> (j) further clarifying the definition of "fundamental restructuring", "hydrocarbon" or "legislative framework" in section 34.1(1) for the purposes of section 34.1;
>
> (k) respecting any other matter relating to section 34.1.

These are fairly standard provisions but they do serve to further enhance the discretion of the executive with respect to the actual implementation of the guarantees conferred by the substantive provisions of the Bill. These powers can also be used to add important clarity by defining key terms such as when a well commences production.

The Legal Status of Bill 12

Bill 12 if passed will be an ordinary statute. It will not be constitutionally entrenched and it is not protected by a manner and form requirement against repeal or amendment. Consequently, there would be no obstacle in domestic law to its repeal. One government cannot bind another. It is possible to envisage foreign investors bringing investment arbitration claims under one of Canada's foreign investment promotion and protection agreements (FIPPA), although a covered investor would certainly face some challenges in fitting such a claim within the narrow scope of the fair and equitable treatment standard in Canada's more recent FIPPAs (see, for example, Article 4 of the Canada/China FIPPA).

Assessment

I do not believe that Bill 12 is necessary. I do not believe that Alberta's governments have taken a whimsical approach to adjusting royalty rates. Instead, for the most part and to a fault, they have proven to be very responsive to concerns raised by industry. For my earlier posts on royalty reviews in Alberta see: Alberta's Royalty Review and the Law of Grandparenting, Why are we Waiting?, and The Sky is Falling, Let's Blame the Royalty Review.

But I also recognize that there are others who took and still take a different view of the Stelmach government's royalty review and who therefore might seek some legislative assurance of royalty stability. This Bill was evidently designed to speak to that constituency. It will be interesting to hear if that constituency considers that its concerns have been addressed.

For my part, the only sure bet is that if Bill 12 is enacted in its current form it guarantees that the validity of all future royalty changes will be challenged in the courts.

This post may be cited as: Nigel Bankes, "Royalty Certainty for the Oil and Gas Industry?" (June 26, 2019), online: ABlawg, http://ablawg.ca/wp-content/uploads/2019/06/Blog_NB_Bill12Royalty.pdf