September 28, 2017

Dear [Redacted]

Re: Your request for access to information under Part II of the Access to Information and Protection of Privacy Act (File # NR-70-2017)

On August 17, 2017, the Department of Natural Resources received your request for access to the following records/information:

On August 1 Order-in-Council OC2017-258 was posted on the OIC website noting: "Under the authority of section 11 of the Executive Council Act and section 33 of the Petroleum and Natural Gas Act, the Lieutenant-Governor in Council is pleased to authorize the Minister of Natural Resources to execute and deliver an Agreement with Husky Energy / Suncor Energy to implement the White Rose Arbitration decision rendered on May 25, 2016 and settle all outstanding White Rose royalty disputes up to January 31, 2008, substantially along the lines of that attached in Appendix B of the Minister's submission."

We would like a copy of the Agreement with Husky/Suncor to implement the White Rose Arbitration decision. We would also like a copy of the White Rose Arbitration decision. As well as a copy of the Minister's decision including Appendix B.

On September 11, 2017 we received approval from the Information and Privacy Commissioner to extend the timeline for your request by 10 business days.

I am pleased to inform you that a decision has been made by the Department of Natural Resources, confirmed by the Deputy Minister, to provide access to some of the requested information.
I note that you sought 3 documents. The White Rose Arbitration Decision and the Agreement with Husky and Suncor is attached, with redactions based on S.35(1)(d), S.35(1)(f), S.35(1)(g), S.39(1)(a)(ii), S.39(1)(b), S.39(1)(c)(i), S.39(1)(c)(iii) and 39(2). The Minister’s submission is withheld in its entirety under S.27(2)(a) and S.27(1)(c). See detailed explanation of redactions below:

S.27(1)(c) In this section, "cabinet record" means a memorandum, the purpose of which is to present proposals or recommendations to the Cabinet;

S.27(2)(a) The head of a public body shall refuse to disclose to an applicant a cabinet record;

S.35(1)(d) The head of a public body may refuse to disclose to an applicant information which could reasonably be expected to disclose information, the disclosure of which could reasonably be expected to result in the premature disclosure of a proposal or project or in significant loss or gain to a third party;

S.35(1)(f) The head of a public body may refuse to disclose to an applicant information which could reasonably be expected to disclose positions, plans, procedures, criteria or instructions developed for the government of the province or a public body, or considerations which relate to those negotiations;

S.35(1)(g) The head of a public body may refuse to disclose to an applicant information which could reasonably be expected to disclose information, the disclosure of which could reasonably be expected to prejudice the financial or economic interest of the government of the province or a public body.

S.39(1)(a)(ii) The head of a public body shall refuse to disclose to an applicant information that would reveal commercial, financial, labour relations, scientific or technical information of a third party;

S.39(1)(b) The head of a public body shall refuse to disclose to an applicant information that is supplied, implicitly or explicitly, in confidence; and

S.39(1)(c)(i) The head of a public body shall refuse to disclose to an applicant information the disclosure of which could reasonably be expected to harm significantly the competitive position or interfere significantly with the negotiating position of the third party,

S.39(1)(c)(iii) The head of a public body shall refuse to disclose to an applicant information the disclosure of which could reasonably be expected to result in undue financial loss or gain to any person;

S.39(2) The head of a public body shall refuse to disclose to an applicant information that was obtained on a tax return, gathered for the purposes of determining tax liability
or collecting a tax, or royalty information submitted on royalty returns, except where that information is non-identifying aggregate royalty information.

As set out in section 42 of the Act you may ask the Information and Privacy Commissioner to review the department’s decision to provide access to the requested information. A request to the Commissioner must be made in writing within 15 business days of the date of this letter or within a longer period that may be allowed by the Commissioner. Your request should identify your concerns with the department’s response and why you are requesting a review.

The request for review may be addressed to the Information and Privacy Commissioner is as follows:

Office of the Information and Privacy Commissioner  
2 Canada Drive  
P.O. Box 13004, Stn. A  
St. John’s, NL. A1B 3V8

Telephone: (709) 729-6309  
Toll-Free: 1-877-729-6309  
Facsimile: (709) 729-6500

Pursuant to section 52 of the Act, you may also appeal directly to the Supreme Court Trial Division within 15 business days after receiving the department’s decision.

Please be advised that responsive records will be published following a 72 hour period after the response is sent electronically to you or five business days in the case where records are mailed to you. It is the goal to have the responsive records posted to the Completed Access to Information Requests website within one business day following the applicable period of time. Please note that requests for personal information will not be posted online.

For further details about how an access to information request is processed, please refer to the Access to Information Policy and Procedures Manual at [http://www.atipp.gov.nl.ca/info/index.html](http://www.atipp.gov.nl.ca/info/index.html).
If you have any questions regarding the processing of your request, please feel free to contact me by telephone at 729-0463 or rhynes@gov.nl.ca.

Sincerely,

RHynes

Rod Hynes
ATIPP Coordinator
AGREEMENT TO EFFECT CONCLUSION OF WHITE ROSE ARBITRATION

THIS AGREEMENT is dated as of August 14, 2017.

BETWEEN:

HUSKY OIL OPERATIONS LIMITED ("HUSKY")

AND:

SUNCOR ENERGY INC. ("SUNCOR")

AND:

HER MAJESTY IN RIGHT OF
NEWFOUNDLAND AND LABRADOR ("PROVINCE")

RECITALS:

UPON Husky, Suncor and the Province (collectively, the "Parties") having appeared before William G. Horton, Allan J. Stitt, and Earl A. Cherniak, Q.C. (the "Tribunal") in St. John's, Newfoundland and Labrador on May 2, 3, 4, 5, and 6, 2016;

AND UPON the Tribunal having issued an Award dated May 25, 2016 (the "May 25 Award"), which is attached to this Agreement as Appendix A;

AND WHEREAS the Parties have jointly sought extensions to the time limits in Article 33 of the Commercial Arbitration Act (Canada) that provide the Parties with the opportunity to request that the Tribunal give an interpretation of a specific point or part of the award and/or make an additional award as to claims presented in the arbitral proceedings;

AND WHEREAS the Tribunal granted the extensions jointly requested by the Parties;

AND WHEREAS the Parties have reached a mutual agreement with respect to the interpretation and implementation of the May 25 Award;

NOW THEREFORE it is agreed that:

1) In the May 25 Award, a majority of the Tribunal found that certain pre-development costs incurred in 2005, 2006, and 2007 were subject to reallocation from the Existing White Rose Project to the Growth Project, pursuant to s. 59(5) of the Royalty Regulations, 2003. This
reallocated costs has a corresponding impact on the royalty payable by each of Husky and Suncor. The amount of royalty payable for each of Husky and Suncor in relation to the Existing White Rose Project as a result of the implementation of the May 25 Award has been agreed between the Parties, as outlined in 3 and 4 below. S. 35(1)(f), S. 35(1)(g)

2) The amounts specifically identified in 3 and 4 below represent the final agreement of the Parties with respect to the royalty share payable by Husky and Suncor for the Existing White Rose Project as a result of the implementation of the May 25 Award. S. 35(1)(f), S. 39(2)

3) The royalty payable owing from Husky as a result of the May 25 Award is

S. 35(1)(f), S. 39(2)

4) The royalty payable owing from Suncor as a result of the May 25 Award is

S. 35(1)(f), S. 35(1)(g)

5) In consideration for the Province agreeing [ ] Husky and Suncor agree as follows:

S. 35(1)(d), S. 35(1)(f), S. 35(1)(g), S. 39(1)(a)(ii), S. 39(1)(b), S. 39(1)(c)(i), S. 39(1)(c)(iii)
7) Subject to the implementation of the May 25 Award consistent with the terms noted above, the arbitral proceedings between the Parties are hereby terminated.

The Parties hereby confirm their consent to the terms outlined above in this Agreement as follows:

______________________________  Husky Oil Operations Limited
Witness

Name:
Title:

______________________________  Suncor Energy Inc.
Witness

Name:
Title:

______________________________  Her Majesty in Right of Newfoundland and Labrador
Witness

Name:
Title:

Note: two appendices to this agreement, consisting of 81 pages in total, have been withheld in full under section 39(2).
IN THE MATTER OF AN ARBITRATION UNDER THE ROYALTY REGULATIONS, 2003 AND THE WHITE ROSE EXPANSION PROJECT FRAMEWORK AGREEMENT

BETWEEN:

HUSKY OIL OPERATIONS LIMITED
AND SUNCOR ENERGY INC.

CLAIMANTS

AND:

HER MAJESTY IN RIGHT OF
NEWFOUNDLAND AND LABRADOR

RESPONDENT

Counsel
For the Claimants: Doug Skinner and James A. MacDuff
For the Respondent: Gregory M. Smith and Amy M. Crosbie

Hearing
May 2, 3, 4, 5 and 6, 2016 in St. John's, Newfoundland and Labrador

AWARD
(May 25, 2016)
Introduction

1. This is an arbitration under the Royalty Regulations, 2003 (the “Royalty Regulations”) made under the authority of s. 39 of the Petroleum and Natural Gas Act, RSNL 1990, c. P-10 (the “PNG Act”), and the White Rose Expansion Project Framework Agreement dated December 14, 2007 (the “Framework Agreement”). The Royalty Regulations apply to leases issued after April 1, 1990.

Background

2. This arbitration is about the assessment of royalty on oil produced from the White Rose Oil Field and the adjacent North Amethyst Oil Field. Both oil fields are located in the offshore area of Newfoundland and Labrador. Four pools are recognized in the White Rose Oil Field: North Avalon Pool, West Avalon Pool, South Avalon Pool, and South White Rose Extension Pool. A single pool is recognized in the North Amethyst Oil Field.

3. Under s. 32 of the PNG Act, oil produced under a lease in Newfoundland and Labrador is subject to payment, by interest holders in the lease, of royalty share to the Province of Newfoundland and Labrador (the “Province”) in an amount and in a manner prescribed by the Royalty Regulations. Each of the Claimants is an interest holder.

4. Pursuant to s. 33 of the PNG Act, the Lieutenant Governor in Council of the Province may make an agreement with an interest holder. Where such an agreement is made and is inconsistent with the Royalty Regulations, s. 33 provides that agreement shall prevail.
White Rose Project

5. Development of the White Rose Oil Field began with the “White Rose Project”, under a lease to the Claimants, which lease originally included all the lands of the White Rose Project (the “White Rose Project Lease”). The White Rose Project was first developed under the White Rose Development Plan Application as approved by the Canada-Newfoundland and Labrador Offshore Petroleum Board (the “Board”), under decision 2001.01 and dated November 26, 2001 (the “Original Development Plan”).

6. The Original Development Plan provided for the development of oil production in the South Avalon Pool. Production of oil was deemed to commence on January 1, 2002. After that date, other exploration and delineation activities were carried out in other areas of the White Rose Oil Field, and capital costs were incurred.

White Rose Expansion Project

7. The Claimants wanted to expand development of the White Rose Oil Field beyond the South Avalon Pool with the “White Rose Expansion Project” in areas that had been explored and delineated.

8. The Province wanted to obtain a higher royalty and a participation interest in the White Rose Expansion Project.

9. The White Rose Expansion Project is described in the Framework Agreement, and puts what was agreed to into effect. The Framework
Agreement was an agreement that can be inconsistent with and over-ride the provisions of the Royalty Regulations, pursuant to s. 33 of the PNG Act

Framework Agreement

10. Under the Framework Agreement, the South Avalon Pool was given the new name “Existing Lands”. The White Rose Project as referenced in the Original Development Plan was continued with respect to the Existing Lands under the new name the “Existing White Rose Project”. The rest of the lands in the White Rose Oil Field, together with the lands in the North Amethyst Oil Field were given the new name “Growth Lands” and the project to develop the Growth Lands was given the name the “Growth Lands Project”.

11. Under Exhibit “J” to the Framework Agreement, the Existing Lands were designated as one “lease” for purposes of the Royalty Regulations. Under Exhibit “I” to the Framework Agreement, the Growth Lands were also designated as one “lease”, separate and apart from the lease which includes the Existing Project. The leases relating to the Existing Lands and the Growth Lands were not named in the Framework Agreement. Nor was either lease given a status in relation to the White Rose Project Lease. In the case of the Existing Lands, any rights that the Claimants held prior to the Framework Agreement continued, but for the fact that those rights were modified to exclude the Growth Lands. In the case of the Growth Lands, and to accommodate a participation interest of a provincial Crown corporation, The Energy Corporation of Newfoundland and Labrador (now “Nalcor”).

12. Exhibit “J” to the Framework Agreement establishes the commencement date of the Existing White Rose Project to be January 1, 2002. The commencement
date is significant because all capital costs incurred prior to the commencement date are treated for royalty purposes as eligible “pre-development costs” under that lease. Thus, the Existing Lands lease retained the same commencement date as the White Rose Project Lease. The commencement date for the Growth Lands Project was subsequently established as January 1, 2008, i.e., the beginning of the year after the Framework Agreement was signed.

13. To state it differently, the Growth Lands include lands and activities (exploratory work and drilling wells) outside the South Avalon Pool that, prior to the Framework Agreement, were carried out under the White Rose Project Lease. Prior to the Framework Agreement, those activities were carried out and the related capital costs were incurred at a time when the Growth Lands were comprised within the White Rose Project Lease for the purposes of the Royalty Regulations. After the Framework Agreement was entered into, those lands were included in the Growth Lands lease, and not included in the Existing Lands lease.

**Issue #1: The Costs Dispute**

14. The first issue in this arbitration relates to the sum of approximately $80,000,000. The issue is whether the manner in which those costs were treated by the Claimants under the White Rose Project Lease prior to the Framework Agreement affects how they are to be treated after the Framework
Agreement, and whether costs incurred under the White Rose Project Lease should be allocated afresh between the Existing Lands lease and the Growth Lands lease, regardless of how they were treated by the Claimants prior to the Framework Agreement.

15. It would appear to be common ground that the Disputed Costs relate to

After the Framework Agreement was signed on December 14, 2007,

16. (We make no comment on the use of estimates for those purposes.)
18. The Claimants take the position that the Disputed Costs are "directly attributable to" the Growth Lands Project and are not "directly attributable to" the Existing Lands Project. Therefore, the Claimants say, once the White Rose Project Lease was split into two leases, pursuant to S. 63(1)(b) of the Royalty Regulations the Disputed Costs could only be claimed under the Growth Lands lease.

19. The Province takes the position that, It is the Province's position that royalty calculations cannot be retroactively changed. The Province also argues that the statutory royalty regime is based on policy considerations independent from commercial reasonableness and that a company that wants to produce oil in the Province must determine whether
it is in its interest to do so, given the royalty regime structure. For example, the Royalty Regulations allow oil-producing companies to deduct eligible costs from revenues when incurred, rather than by matching revenues and expenses as commercial reasonableness would suggest absent the Royalty Regulations. The Province argues that the Royalty Regulations also prevent the Claimants from transferring those expenses from one lease to another, even if it is commercially reasonable and logical to do so.

20. Alternatively, the Province argues that, \[ S.39(2) \]

21. At one point in the arbitration, the Province appeared to suggest that the manner in which the Claimants recorded the Disputed Costs in their own records, apart from royalty filings with the Province, could have some impact on the issues to be decided in this arbitration. Despite having been given considerable latitude to explore that possibility in the arbitration through information and document requests and an examination for discovery, the Province has failed to persuade us that the manner in which the costs were internally recorded by the Claimants has any bearing on the issues before us.

*The Royalty Regulations*

22. The relevant provisions of the Royalty Regulations are as follows:

*Section 4(1)*
And interest holder is liable to the Crown for royalty share calculated in accordance with these regulations and that royalty share may be taken in kind or paid in money at the option of the minister.

Section 3

(1)(v) "royalty cost" means a cost that is an eligible operating cost, eligible capital cost, eligible predevelopment cost or a net decommissioning cost"

Section 5

(1) basic royalty and incremental royalty are due on the last day of the month following the month to which the royalty relates.

Section 15

(1) a cost or part of a cost that has been claimed, deducted or included by an interest holder in a lease in the calculation of royalty share cannot be claimed, deducted or included by that interest holder or another interest holder in a calculation of royalty share under that lease or another lease.

Section 31

(1) an interest holder in a lease commencing with production under that lease, shall file with the minister a monthly report in the required form.

Section 32

(1) an interest holder shall, not more than 120 days after the end of each period, file an annual reconciliation in the required form with other information that is sufficient for the minister to determine royalty share under the Act and these regulations.

...

(3) where, as a result of the annual reconciliation, it is determined that an interest holder has underpaid royalty share, then the amount of underpayment shall be remitted to the minister with the annual reconciliation.
(4) where, as a result of the annual reconciliation, it is determined that an interest holder has overpaid royalty share, the amount of overpayment shall be repaid by the crown to the interest holder within 30 days of the filing of that reconciliation or, upon the written request of the interest holder, may be credited to the account of the interest holder for royalty share payable.

Section 59

(5) where, after a capital asset has been acquired, the percentage of expected use of that asset over the expected life of the lease changes from the amount previously established and the expected use of that asset is

(a) less than the previously determined use of that asset, incidental revenue shall accrue in the period of the change in use and will equal the original cost of the asset, multiplied by the change in the expected use of the asset for the purpose of the lease; or

(b) greater than the previously determined use of that asset, an amount for eligible capital cost shall accrue in the period of the change of use and will equal the original cost of the asset, multiplied by the change in the expected use of that asset for the purpose of the lease.

Section 63

(1) a cost shall qualify as an eligible predevelopment cost, an eligible capital cost, an eligible operating cost or a decommissioning cost under a lease only to the extent that:

(a) it is a cash payment;
(b) it is directly attributable to exploration, development, production or decommissioning activities under the lease or was incurred to market oil produced under a lease provided that the marketing cost complies with paragraph 68 (1) (f);
(c) it is reasonable in relation to the circumstances under which it is incurred;
(d) it is not a cost under another lease within Newfoundland and Labrador;
(e) ... (f) it meets all other requirements of these regulations.

Section 64

(1) Predevelopment costs include
(a) costs incurred before the commencement date; and
(b) costs that were incurred after the commencement date for the purpose of exploration on project lands.

Section 69

(1) incidental revenue is consideration received or deemed to be received or declared by the interest holder or the project operator on behalf of the interest holder from the following:

(a) sale, lease, license or other disposal or use of lease assets or technology under the lease where the costs were royalty cost under the lease;
(b) ...
(c) amounts required to be included as incidental revenue under section 59;
(d) ...
(e) ...

Interpretation of the Royalty Regulations and the Framework Agreement

23. There is no dispute between the parties regarding the principles of interpretation to be applied to statutes, regulations and contracts. For ease of reference, we have adopted the description set out in the Province's submissions.

Principles of Statutory Interpretation

24. Statutory interpretation involves a "consideration of the ordinary meaning of words used and the statutory context in which they are found. [...] The words, if clear, will dominate; if not, they yield to an interpretation that best meets the overriding purpose of the statute": See Celgene Corp. v. Canada (Attorney General) (SCC), 2011 CarswellNat, at para. 21:
The parties both relied on the approach used in Canada Trustco Mortgage Co. v. Canada, 2005 SCC 54, [2005] 2 S.C.R. 601, at para. 10, which confirmed that statutory interpretation involves a consideration of the ordinary meaning of the words used and the statutory context in which they are found:

It has been long established as a matter of statutory interpretation that "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament": see 65302 British Columbia Ltd. v. Canada, [1999] 3 S.C.R. 804, at para. 50. The interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis to find a meaning that is harmonious with the Act as a whole. When the words of a provision are precise and unequivocal, the ordinary meaning of the words play a dominant role in the interpretive process. On the other hand, where the words can support more than one reasonable meaning, the ordinary meaning of the words plays a lesser role. The relative effects of ordinary meaning, context and purpose on the interpretive process may vary, but in all cases the court must seek to read the provisions of an Act as a harmonious whole.

The words, if clear, will dominate; if not, they yield to an interpretation that best meets the overriding purpose of the statute.

Regulations are subject to the same rules of interpretation as statutes themselves. The interpretation of a regulation also requires consideration of the purpose and context of the enabling statute, and more specifically the section which confers the powers to enact regulations, as an additional element to be factored into the modern approach to interpretation. The intent of the statute transcends and governs the intent of the regulation. See

26. The modern principle of statutory interpretation emphasizes the importance of purposive analysis in statutory interpretation ensuring the legislature's purposes - including both the purpose of the Act as a whole and the purpose of the particular provision to be interpreted - are identified and taken into account in every case. See R. Sullivan, Sullivan on the Construction of Statutes, 6th ed. (Markham: LexisNexis Canada, 2014), at p. 259.

27. The aim of interpretation is not to discover legislative intent by whatever means are necessary, but to apply the will of the legislature as it can be understood from the text: see P. Cote, The Interpretation of Legislation in Canada, 4th ed. (Toronto: Thomson Reuters Canada Ltd., 2011), at p. 315.

28. When the text of the statute is precise, its meaning appears to be clear and concerns about the right of the citizen to rely on what the text appears to say are more than purely formal, the apparent meaning of the text properly outweighs evidence of a contrary intention derived from extrinsic materials: see R. Sullivan, Sullivan on the Construction of Statutes, supra, at p. 660.

29. The Supreme Court has cautioned against judicial rewriting of legislation under the guise of interpreting it: see Wilson v. British Columbia (Superintendent of Motor Vehicles), 2015 SCC, at para. 27:

Mr. Wilson submits that the officer's belief must be based not only on the ASD result, but also on confirmatory evidence showing that the driver's ability to drive is affected by alcohol. I would reject this interpretation. It is not supported by the text of the provision, and it requires the court to read in words that are simply not there. This Court has cautioned against judicial rewriting of legislation under the guise of interpreting it:
... the contextual approach allows the courts to depart from the common grammatical meaning of words where this is required by a particular context, but it does not generally mandate the courts to read words into a statutory provision. It is only when words are "reasonably capable of bearing" a particular meaning that they may be interpreted contextually. ... The Crown is asking this Court to read words into s. 34(2) which are simply not there. In my view, to do so would be tantamount to amending s. 34(2), which is a legislative and not a judicial function.

*Principles of Contract Interpretation*

30. The "interpretation of contracts has evolved towards a practical, common-sense approach not dominated by technical rules of construction. The overriding concern is to determine the intent of the parties and the scope of their understanding": see *Creston Moly Corp. v. Sattva Capital Corp.*, 2014 SCC 53, at para. 46 and 47.

31. This evolution embodies the principles of justice and fairness. Where it is presumed that the parties intended the legal consequences of their words, it will always be just and fair to give effect to the true contractual intent of the parties no matter what the intended legal consequences.

32. The starting point in the interpretive exercise is giving effect to the words used by the parties: "effect must be first given to the intention of the parties to be gathered from the words they have used" in the document: see *Consolidated-Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co. [1979] S.C.J. No. 133 (S.C.C.) at 889*. Context of the document requires that the interpretation of a word or group of words has regard for the way language is used in the document as a whole: see Geoff R. Hall, *Canadian Contractual Interpretation Law, 2nd* ed., infra, at p. 12.
33. It is "a cardinal presumption" that the parties have intended what they have said in a contract: see *Ventas, Inc. v. Sunrise Senior Living Real Estate Investment Trust*, [2007] O.J. No. 1083 (Ont. C.A.) at para. 24. This is best achieved by reading the "the contract as a whole, giving the words used their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract": see *Creston Moly*, *supra*, at paras. 56-58.

34. The interpretation of a written contractual provision "must always be grounded in the text and read in light of the entire contract": see *Creston Moly*, *supra*, at para. 57. "To ascertain the true intention of the parties, the decision maker must look at each provision in the context in which it is found and, in construing it, regard must be had to the language used in that and other parts of the document to avoid inconsistency": see Hall, *Canadian Contractual Interpretation Law*, *supra*, at p. 9. The words used must be given "their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract": see *Creston Moly*, *supra*, at para. 47. "An interpretation which strays too far from the words selected by the parties is not legitimate" see Hall, *Canadian Contractual Interpretation Law*, *supra*, at p. 9.

35. It "is unnecessary to consider any extrinsic evidence at all when the document is clear and unambiguous on its face": see *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129 (S.C.C.).

36. While the surrounding circumstances will be considered in interpreting the terms of a contract, "they must never be allowed to overwhelm the words of that agreement" and they "cannot be used to deviate from the text such that the court effectively creates a new agreement": see *Creston Moly*, *infra*, at para. 57. This also applies to extrinsic evidence.
37. The nature of the evidence that can be relied upon under the rubric of "surrounding circumstances" will necessarily vary from case to case and it has "its limits": see Creston Moly, supra, at para. 58. This applies to any evidence of the "usages of the trade applicable to the transaction." Such evidence "must never be allowed to overwhelm the words of agreement" and "the [tribunal] cannot use them to deviate from the text such that the [tribunal] effectively creates a new agreement."

How Many Leases?

38. Considerable effort was expended by counsel in their submissions, and in their discussions with the tribunal, on the question of how many leases should be considered to exist in resolving the issue relating to the allocation of the Disputed Costs between or among them. Although the discussion, at times, took on a metaphysical character and became somewhat confused by the application of different labels to the leases as they existed at different times, the essential positions of the parties can be stated as follows:

a. the Province takes the position that the White Rose Project Lease and the Existing Lands lease are one and the same lease. The latter just applies to less land as the Growth Lands were carved out. Therefore, capital costs that were claimed, deducted or included in royalty calculations with respect to that (single) lease, and which were directly attributable to that lease when they were incurred, cannot subsequently be claimed, deducted or included in royalty calculations with respect to the Growth Lands lease, which the Framework Agreement explicitly provides is a lease that is "separate from the 'lease' that includes the Existing Lands" (see Exhibit "I" s. 1.4).

b. the Claimants take the position that the effect of the Framework Agreement was to split the White Rose Project Lease into two leases,
one relating to the Existing Lands and the other relating to the Growth Lands. From the Claimant's perspective, it does not matter whether, technically, the White Rose Project Lease was continued as the Existing Lands lease. After the Framework Agreement was entered into, costs that were previously attributable to the White Rose Project as a whole, but which were attributable to the Growth Lands and not the Existing Lands, should now be claimed, deducted or included in the royalty calculations with respect to the Growth Lands lease.

39. Having considered the issue, the tribunal\(^1\) is not persuaded that it is necessary to determine the legal relationship between or among the leases. Rather, subject to any change brought about by the Framework Agreement itself (which issue is discussed below), what must be considered in terms of the allocation or re-allocation of costs is the relationship between a given set of costs and any given lease at the time the costs were incurred, and at the time they were sought to be claimed, deducted or included.

Application of the Royalty Regulations to the Disputed Costs

40. It may be useful to begin with an example on which the parties appear to agree.

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\(^1\) References to "the tribunal", "we" or "us" in this Award are references to all three members of the tribunal except in those instances in which Mr. Cherniak, in his separate reasons, has offered a different explanation for his conclusion. In those instances, the reference is to the other two members of the tribunal.
As counsel for both sides agreed: "Costs can be banked". After the Framework Agreement was entered into, those costs that were incurred at a time when they were eligible to be claimed under a lease, but which were not claimed under that lease when incurred, can be claimed under another lease for which the eligibility criteria are met, without offending the double counting rule in s. 15(1) of the Royalty Regulations. There does not appear to be any dispute between the parties with regard to the foregoing analysis.

41.

42.

under another lease, so we must look at s. 63.
43. The Claimants take the position that, in the circumstances where, as here, one lease has been divided into two parcels of land under two different leases, the intent of s. 63(1)(b) is achieved by allocating, or reallocating, costs to whichever of the two new leases those costs are "directly attributable".

44. They state that s. 63(1)(d) of the Royalty Regulations does not prevent them from allocating the Disputed Costs to the Growth Lands lease as s. 63(1)(d) is merely there to prevent double counting. The Claimants readily acknowledge that double counting is not allowed, but state that the reallocation and the recalculation of royalties for oil produced under the White Rose Project Lease ensures that this case is not one where double counting can be alleged to have occurred.

45. The Province asks us to draw the conclusion that s. 63(1)(d) of the Royalty Regulations prevents more than double counting. They note that s. 15 of the Royalty Regulations specifically prevents double counting, and that if s. 63(1)(d) were to be given meaning, it must apply to more than double counting. The majority of the arbitration panel agrees. We believe that s. 63(1)(d) prevents the Claimants from taking a cost that was eligible and was claimed as a cost under a lease, and moving that cost to another lease, without a provision of the Royalty Regulations that allows them to do so.

46. While we therefore accept that the Claimants can claim eligible costs under the Growth Lands lease where those costs were never claimed, deducted or included in royalty calculations prior to the Framework Agreement, i.e. under the White Rose Project Lease, we find that costs that were eligible and claimed, deducted or included under a lease cannot be deducted under another lease unless the Royalty Regulations provide a mechanism for doing so.
47. In this case, s. 59(5) of the Royalty Regulations not only provides the Claimants with a mechanism for doing so, it requires them to follow that mechanism in circumstances to which it applies.

48. Section 59(5) of the Royalty Regulations is a necessary provision to deal with cost reallocation when there is a change of expected use of an asset over the life of the lease with respect to which the cost was deducted. As noted above, the royalty regime allows the Claimants to deduct the entire amount of some capital costs (for the purpose of determining royalties) at the time the costs are incurred, rather than amortizing the costs over the life of the asset (which would otherwise occur so as to match revenues and expenses). When the entire cost of an asset is deducted before the asset is used up or depleted, and where the asset is now no longer used to earn revenue in relation to the lease under which the cost was deducted, and where the asset now provides benefit elsewhere, s. 59(5), deals expressly with how the cost reallocation is to occur.

49. The Disputed Costs relate to capital assets; i.e., the delineation wells and other infrastructure on the Growth Lands. After the Framework Agreement was entered into, the percentage of the expected use of those assets over the expected life of the lease changed such that the expected use of the assets was less than previously expected under that lease. Thereafter, the assets would no longer be used under the White Rose Project Lease or under the lease relating to the Existing Lands. They would only be used in the Growth Lands and, given that the Growth Lands were not yet in production, all of the costs relating to those assets would be pre-development costs for the benefit of the Growth Lands. Section 59 of the Royalty Regulations therefore applies and those costs must
be allocated according to their new expected use. In this case, the expected use has changed to 100% for the Growth Lands and 0% for the Existing Lands

50. The Claimants argued that s. 59 is only applicable to assets that were shared between two leases before the change in use occurred. There is nothing in the section to indicate that to be the proper interpretation. The plain language of the section applies to a change in use that results in a capital asset that is acquired for use in one lease being subsequently used for another lease, or for another purpose entirely. The formula set out in the section is readily applied to any percentage allocation that might be necessary, from zero to 100%. No obvious purpose is served by introducing a requirement that some minimum percentage of residual use must remain with the original lease.

51. In this case, where the assets, and costs relating to them, are physically and immovably located on a particular piece of land, it is obvious that the assets, which were previously expected to be fully utilized over the expected life of the White Rose Project Lease, will no longer be able to be used at all under that lease but will be fully utilized under the lease relating to the Growth Lands. In these circumstances, on its plain wording, s. 59(5) applies.

52. We note that the Claimants argued that this analysis could result in an absurdity in cases where costs are deducted in error and the error is later discovered. The regime must permit a re-allocation in such cases and s. 59(5) would not apply. We agree that the regime allows for correction of errors, but we think that our analysis of the application of the Royalty Regulations to the Disputed Costs is not inconsistent with an interpretation of the Royalty Regulations that requires errors to be corrected. The parties agree that, in this case, the Disputed Costs were eligible at the time they were deducted under the White Rose Project Lease. We are therefore dealing with costs that
were eligible and properly deducted. In the case of a mistake, no costs would have been eligible and they would therefore have not properly been a “cost under another lease” so they can be allocated where they should correctly be allocated once the error is discovered.

53. The tribunal does not comment as to whether the application of s. 59(5) would result in a [S.39(2)]

[We note that the approach taken by the Claimants resulted [59(5)]

[We have not been asked to determine the impact of the calculations required by s. 59(5) once the expected use of the asset has changed, and we leave that to the parties.]

54. Therefore, unless the Framework Agreement itself provides a different solution, s. 59(5) must be the mechanism under the Royalty Regulations by which the reallocation is to be done.

*Does the Framework Agreement Change the Result?*

55. The Province takes the position that the Framework Agreement overrides the application of s. 59(5) of the Royalty Regulations with the result that the reallocation of the Disputed Costs from the White Rose Project Lease to the Growth Lands lease is disallowed completely. In support of its position, the Province cites the identically worded provisions of Exhibit “I” s. 1.5 and Exhibit “J” s. 1.6 which state as follows:

Notwithstanding S. 59(5) of the Royalty Regulations, where the Proponents have acquired capital assets which qualify under the Royalty Regulations as eligible capital costs of the Existing White Project prior to the startup of the
production of Oil from the Growth Project, other than as specifically provided for herein there shall be no accrual of incidental revenue to the Existing White Rose Project, nor reallocation of the eligible costs relating to those capital assets to the Growth Project as a result of their use for the benefit of the Growth Project.

56. Although the general sense of this provision seems to accord with the Province's interpretation, we are persuaded by the submissions of the Claimants that this provision was intended to apply specifically to costs which, prior to the Framework Agreement, were attributable to some extent to the lands which subsequently were included in the Existing Lands lease; in other words, these provisions apply to assets which were shared to some degree between the Existing Lands and the Growth Lands as they came to be known under the Framework Agreement. The principal asset in this latter category was a floating oil production platform (the "FPSO") to which wells in all areas of the White Rose Oil Field could be connected, the cost of which is substantial.

57. The surrounding circumstances relating to the negotiation of the Framework Agreement make it clear that
58. Also relying on evidence as to the surrounding circumstances, the Province argues that

59. The Claimants take the position that, Consequently, they submit, in the absence of any specific provision to the contrary in the Framework Agreement, the Royalty Regulations are applicable, and provide for reallocation of the Disputed Costs.
60. The Province agrees that the costs can be reallocated if the Framework Agreement does not preclude that. But the Province says that, in that case, s. 59(5) of the Royalty Regulations applies.

61. In our view, the evidence relating to the negotiations that preceded the Framework Agreement is not helpful in deciding the issue before us. That evidence...

62. The explanation put forward by the Province, namely that s. 1.5 of Exhibit "I" and s. 1.6 of Exhibit "J" are the provisions which exclude the reallocation of the Disputed Costs, is not one which we find persuasive for the following reasons.

63. It is clear in the language of s. 1.5 of Exhibit "I" and s. 1.6 of Exhibit "J" that those sections relate only to "capital assets which qualify under the Royalty Regulations as eligible capital costs of the Existing White Rose Project prior to the startup of the production of Oil from the Growth Project". The Province has consistently attempted to equate the "Existing White Rose Project" to the project under the White Rose Project Lease. However, the former is a defined term under the Framework Agreement, the meaning of which in relevant part is "the project described under the White Rose
Development Plan Application ... and relating to the Existing Lands”. There is no reference to the White Rose Project Lease. “Existing Lands” is a defined term meaning, in non-technical parlance, the lands that correspond to the South Avalon Pool. Given those definitions, only capital assets that qualify as eligible capital costs relating to the Existing Lands are caught by the provisions under discussion. Costs which are caught by this definition are those relating to assets such as the FPSO, as these costs would qualify as eligible capital costs of both the Existing White Rose Project and of the Growth Project, as those terms are defined under the Framework Agreement. The Disputed Costs that relate only to the Growth Lands and not at all to the Existing Lands are not caught by this definition.

64. The Disputed Costs were not eligible costs that relate or ever related to the Existing Lands. Therefore, we agree with the position of the Claimants that s. 1.5 of Exhibit “I” and s. 1.6 of Exhibit “J” do not apply to the Disputed Costs. However, for reasons previously given, the majority of the panel agrees that the Disputed Costs are subject to reallocation under s. 59(5) of the Royalty Regulations.

65. The majority of the panel has considered the submissions of the Claimants with respect to s. 1.1 of Exhibit “I” the Framework Agreement, and these submissions have been accepted by Mr. Cherniak. The argument is that this section permits the direct reallocation of costs (other than those caught by ss. 1.5 and 1.6 respectively of Exhibits “I” and “J”) without the application of s. 59(5) of the Royalty Regulations. The majority is not persuaded by this submission, for the following reasons:
a. The thrust of s.1.1 is to "crystallize" certain definitions and provisions in the Royalty Regulations so that they can not be changed unilaterally by the Province after September 10, 2007.

b. There is nothing in the section that suggests that the intended effect is to change any aspect of the provisions expressly referenced in s. 1.1, or any other aspect of the Royalty Regulations.

c. There can be no doubt that, even if s. 1.1 did not exist, the entirety of the Royalty Regulations, including the provisions referenced in s. 1.1 would apply to the Growth Lands. Therefore, the purpose of the section must clearly be to ensure only that the referenced provisions would not be changed after September 10, 2007, not that they would apply differently than they would have but for s. 1.1.

d. For the other reasons mentioned, we accept the submissions of the Claimants, as well as the conclusions accepted by Mr. Cherniak, to the effect that the Disputed Costs can be reallocated. These arguments depend not on s. 1.1 of Exhibit "I" but upon the sections of the Royalty Regulations that happen to be mentioned in s. 1.1.

e. We are not persuaded that there is anything in s. 1.1 that was intended to create a gap in the regulatory regime with respect to how that reallocation is to take place, such that it was left entirely to the Claimants as to how that was to be done.

f. In the absence of an explicit provision to the contrary, the majority of the panel is of the view that the preservation of the royalty regime, including methods by which costs previously claimed under one lease are to be reallocated to another lease, is strongly implied by s. 1.1.

g. In any event, and perhaps more directly to the point, there is nothing in the Framework Agreement (including s. 1.1 of Exhibit "I") which is inconsistent with s. 59(5) of the Royalty Regulations. Therefore, s. 59(5) applies to the reallocation.
Issue #2: Initially Established Reserves of Oil

66. The issue with respect to initial established reserves ("IER") is whether the calculation of IER for the Growth Project should include Husky's reserves estimate for the West Avalon Pool (in addition to the reserves estimate of 93.8 million barrels for the North Amethyst Field and the South White Rose Extension).

67. Husky on behalf of the Claimants is solely responsible for planning the development of the South White Rose Extension, North Amethyst Field and West White Rose Extension portions of the Growth Lands.

68. Section 89(1)(a) of the Royalty Regulations provides as follows:

"initial established reserves" means reserves established prior to the start of the production of oil in accordance with the development plan approved by the board...

69. Husky had a sufficient level of understanding of reserves and expectation of oil production prior to the start of production of oil (May 31, 2010) for full development of the South White Rose Extension and North Amethyst Field to proceed with development plans for those areas that were approved by the Board; but a greater level of understanding and knowledge was required before they committed to develop the West Avalon Pool and before they submitted a development plan to the Board for approval.

70. Husky determined that, if it waited until it had enough information about the West Avalon Pool before proceeding with Board applications for the South White Rose Extension and the North Amethyst fields, that would delay oil production on the latter two properties. Husky decided that these delays would have a negative impact on overall profitability of the project with
respect to the Growth Lands. As a result, after it received approval from the Board for its development plans for the South White Rose Extension Pool and the North Amethyst Field, Husky proceeded to produce oil from those fields and applied for pilot project development approval with respect to the West Avalon Pool.

71. In the end, Husky progressed the development of the Growth Lands under multiple development plans, as follows:

a. the South White Rose Extension Development Plan Amendment, which relates to South White Rose Extension (the “South White Rose Extension Development Plan”);

b. the North Amethyst Development Plan, which relates to North Amethyst Field (the “North Amethyst Field Development Plan”);

c. the White Rose Development Plan Amendment, West White Rose - Pilot Scheme, which relates to West Avalon Pool (the “West White Rose Pilot Scheme Development Plan”); and

d. the White Rose Extension Project - White Rose Development Plan Amendment, which also relates to the West Avalon Pool (the “full scale West White Rose Extension Development Plan”).

72. The objective of the West White Rose Pilot Scheme Development Plan was to obtain additional information to allow Husky to assess whether full development of the West White Rose Extension would be feasible. Depending upon the results of the pilot scheme, Husky would decide whether to proceed with full development of the West White Rose Extension. This would require a subsequent development plan application to the Board for the full-scale West White Rose Extension Development Plan. That had not
occurred at the time the Claimants filed the Notice of Arbitration and the Respondent filed its Reply to Notice of Arbitration, but has occurred since.

73. It is not in dispute that:

a. the "start of the production of oil" in the Growth Lands occurred on May 31, 2010;

b. as of May 31, 2010, the only development plans approved by the Board with respect to the Growth Lands were those which related to the South White Rose Extension and the North Amethyst Field;

c. the development plans which were approved by the Board with respect to the South White Rose Extension and the North Amethyst Field included initial reserves calculated by Husky in the amounts of 24 million barrels and 69.8 million barrels respectively (for a total of 93.8 million barrels);

d. the development plan for the West Avalon Pool that was ultimately approved by the Board included initial reserves for that plan, as calculated by Husky, in the amount of 107.6 million barrels;

e. At the time of the signing of the Framework Agreement, Husky estimated that initial reserves in the West Avalon Pool were 120 million barrels.

74. The significance of IER for the calculation of royalties payable under a lease is that the initial low rate of 1% is only payable until the production of oil on which an interest holder’s share is calculated reaches either 50 million barrels or the interest holder’s share of 20% of the IER of oil under the lease, whichever is lower: s. 90(1) of the Royalty Regulations. After that point is
reached, royalties are payable under the lease at a rate of 2.5%.

75. Thus:

   a. the definition of IER [s. 89(1)(a)] sets a point in time when the IER
      must be determined; i.e., prior to the start of production that occurs in
      accordance with a development plan; and

   b. the potential benefit to an interest holder is greater the larger the size
      of the IER, up to a maximum as set out above.

76. The Claimants suggest that s. 89(1)(a) is unclear when applied to the unique
    circumstances of the Framework Agreement. They suggest that the issue to
    be resolved is how IER is to be determined where more than one
    development plan (or development plan amendment) is required under a
    lease, and production occurs in one area before all development plans have
    been submitted to the Board. However, we are not persuaded that the
    Framework Agreement created a unique situation in that regard or that the
    application of s. 89(1)(a) is unclear.

77. What is clear on the evidence before us is that the development of oil
    production under all of the areas covered by a single lease may proceed
    under different development plans. Indeed, that likely would have been the
    case with respect to the White Rose Project Lease, had the Framework
    Agreement never been entered into. The Original Development Plan only
    covered the South Avalon Pool, though the Claimants did have estimates for
    reserves for the other pools. There appears to be no dispute that only the IER
    under the Original Development Plan would have counted for royalty
    calculation purposes had the development of the other areas under the White
    Rose Project Lease proceeded at later dates and under that lease.
78. Whatever the legislative purpose may have been in framing the IER component of the royalty regime in the terms of s. 89(1)(a), there is no reason to treat the multiple development plans with respect to the Growth Lands differently than they would have been treated under the White Rose Project Lease.

79. The Claimants suggest that the Framework Agreement provides a context which leads to a different result. Specifically, they refer to the evidence that, at the time of the negotiations of the Framework Agreement, all parties were aware that reserves estimates had been identified in each separate area of the Growth Lands and the development would be proceeding in stages. They also note that Husky's P50² reserve estimate of 120 million barrels for the West Avalon Pool was acknowledged by the parties as part of the aggregate of 214 million barrels of initial reserves mentioned in Exhibit "D" to the Framework Agreement, the exhibit that detailed the terms upon which Nalcor would acquire a participation interest in the Growth Lands. The Claimants also point to the fact that Husky's initial reserves estimates in development plans submitted to the Board have always been approved, despite minor deviations from those estimates by the Board's own staff.

80. The Claimants argue that:

a. an interpretation of IER that would include Husky's reserve estimates for the West Avalon Pool aligns with sound commercial principles and business efficacy;

b. Husky's decision not to delay production in the South White Rose Extension and the North Amethyst Field benefited both the Province and the Claimants; and

² "P50" refers to the level of probability that reserves can be commercially recoverable from a particular oil field or pool. It is the level of probability that is used in estimating IER in a development plan.
c. accepting the Province's interpretation would lead to the commercially absurd scenario in which the reserves estimate for the West Avalon Pool is effectively treated as zero, despite the fact that significant reserves were clearly known and acknowledged long before production of oil began under the Growth Lands lease.

80. We acknowledge the force of these arguments from a purely commercial perspective; however, they do not fit easily with the Claimants' acknowledgment that, for royalty purposes, IER are set in relation to a lease and not in relation to individual development plans. To make an exception to the clear wording of s. 89(1)(a) on the basis of generalized evidence as to the level of certainty as to recoverable quantities of oil in areas of land under a lease not covered by a specific development plan or a specific Board approval – and to do so on the basis of an assessment as to whether or not it is preferable to proceed with immediate development or to await a more comprehensive development plan – seems to us to import uncertainty and possible contention into a very clear provision of the regulatory scheme.

81. Further, it is admitted that at the time of the Original Development Plan in relation to the White Rose Project Lease, the Claimants had P50 estimates of reserves for pools that were not being submitted for approval under that Plan, and that there was no expectation of IER for those reserves under the White Rose Project Lease because the IER would not be established prior to the start of the production of oil in accordance with the development plan approved by the Board. In the case of the Growth Lands lease, the same situation arises, where there is a plan before the Board and an estimate of P50 oil in the other pools. The Claimants argue that the result should be different because the Claimants were more confident in the accuracy of the P50 number for the Growth Lands at the time of the start of production of oil than they were for the Existing Lands.
82. We do not believe it was the intention of the Royalty Regulations to establish initial reserves for royalty purposes based upon generalized evidence of the level of confidence the owners have at any given point in time, or from time to time. The Regulations are clear that the level of IER under a lease is established when a development plan is put before and approved by the Board.

83. We are therefore unable to grant the relief requested by the Claimants with respect to the IER issue.

Disposition

84. The tribunal therefore determines as follows:

a. the Disputed Costs are subject to s. 59(5)(a) of the Royalty Regulations and the application of that section is not over-ridden by the Framework Agreement; and

b. only the reserves in the development plans approved by the Board for the South White Rose Extension Pool and the North Amethyst Field prior to May 31, 2010 count towards IER for the lease relating to the Growth Lands.

85. Submissions as to costs may be made in writing within 15 days hereof. Reply submissions shall be delivered within a further 15 days. The tribunal will provide any further or other directions that may be needed.
Partial Dissent

1. I agree with the disposition by my colleagues on the issue of the initial established reserves. With respect to the Disputed Costs issue, I agree that s. 1.5 of Exhibit "I" of the Framework Agreement and s. 1.6 of Exhibit "J" of the Framework Agreement do not preclude the Claimants from attributing the Disputed Costs to the Growth Lands and Growth Lands lease, because those costs solely relate to the Growth Lands Project on the Growth Lands lease.

2. However, I have reservations about my colleagues' application of the Royalty Regulations to the Disputed Costs, specifically their reliance on s. 59(5)(a) of the Royalty Regulations as the basis for their conclusions. While I agree that the words of s. 59(5)(a) may be capable of the meaning that my colleagues ascribe to them, in my view, having regard to the submissions before us, there is at the very least ambiguity in that section that does not appear to me to be resolved by either the extrinsic evidence or the evidence of the surrounding circumstances.

3. S. 59(5) reads:

59. (5) Where, after a capital asset has been acquired, the percentage of expected use of that asset over the expected life of the lease changes from the amount previously established and the expected use of that asset is

(a) less than the previously determined use of that asset, incidental revenue shall accrue in the period of the change in use and will equal the original cost of the asset, multiplied by the change in the expected use of the asset for the purpose of the lease; or

(b) greater than the previously determined use of that asset, an amount for eligible capital cost shall accrue in the period of the change of use and will equal the original cost of the asset, multiplied by the change in the expected use of that asset for the purpose of the lease.

4. The Claimants' counsel specifically stated that the Claimants do not rely on s. 59(5)(a) and (b) as the basis for their position on the Disputed Costs issue. Rather, the Claimants' interpretation of s. 59(5)(a) and (b) is that it applies only to the case where the percentage of expected use of a capital asset changes over the expected
life of a lease, such that it is necessary to apportion the costs between two or more leases, and that the section does not apply to a case where the costs relating to the asset in question were completely and properly removed from one project to another.

5. The Claimants argue, in my view correctly, that in the case of the assets represented by the Disputed Costs, which comprise delineation and exploration on lands located in the Growth Lands lease, the previously established "percentage of expected use" of the assets over the life of the White Rose Project Lease did not "change". It was entirely terminated. The change was to the underlying lease structure that applied to where the assets were located, but the expected use of the assets over the expected life of that lease remained the same. Thus, the "percentage of expected use" of the assets is entirely for the Growth Lands Project and Growth Lands lease. The capital assets represented by the Disputed Costs were never used for the production of oil for the South Avalon Pool.

6. In my view, that is not only a possible interpretation of s. 59(5)(a) (and therefore at the very least raises an ambiguity), but is one that more logically applies the wording of the section, which does not appear to contemplate a 100% change of use of an asset, but rather a shared use. That interpretation for me resolves any ambiguity that may exist. However, I accept that the interpretation adopted by my colleagues is a possible one, though I disagree with it.

7. In my view, given that s. 59(5)(a) is inapplicable, there remains a more cogent reason why the Claimants' position on the Disputed Costs is the correct one.

8. The Disputed Costs, when incurred, were capital costs, because they were incurred after what became the commencement date of the South Avalon Pool (January 1, 2002) in the years before the Framework Agreement was entered into, when the only lease extant, the White Rose Project Lease, encompassed all the lands, including those lands that became the Growth Lands and the Growth Lands lease when the Framework Agreement came into force in December 2008.

9. When incurred, the Disputed Costs were entirely related to the delineation, exploration and development of oil and gas resources on lands that were in the
White Rose Project Lease but were unrelated to the South Avalon Pool. Had the Growth Lands Project and the Growth Lands lease been extant at the time those costs were incurred, they would have been designated as pre-development costs, as defined in sections 63 and 64 of the Royalty Regulations.

10. When the Framework Agreement came into effect, the lands that had comprised the White Rose Project Lease were separated into two separate leases, encompassing two separate areas of land. What came to be called the Existing Lease and the Existing Lands Project incorporated the South Avalon Pool and what came to be called the Growth Lands lease incorporated the lands of the Growth Lands Project and were the lands on which the Disputed Costs had been expended.

11. That being the situation as a result of the Framework Agreement, the Claimants took the position that the Disputed Costs that had been incurred in the delineation, exploration and development of lands that were encompassed by the Growth Lands lease and the Growth Lands Project became properly claimable as eligible pre-development costs with respect to the Growth Lands lease and Growth Lands Project.

12. The issues on the costs dispute in this arbitration are whether, when the Framework Agreement came into effect, the Claimants were entitled to remove the Disputed Costs from the Existing Lease and attribute them to the Growth Lands lease and Growth Lands Project and whether they were precluded from doing so by the requirements of s. 1.5 of Exhibit "I" of the Framework Agreement and s. 1.6 of Exhibit "J" of the Framework Agreement.

13. I have already indicated that I agree with my colleagues' view of the non-applicability of Exhibits "I" and "J" to the Framework Agreement to prevent the removal and reattribution.
14. As stated above, it is not in dispute that the Disputed Costs when incurred were with respect to delineation, exploration and development on lands that became the Growth Lands lease and Growth Lands Project and were in no way related to delineation, exploration and development of the lands that remained in the Existing Lease and the Existing Lands Project after the coming into force of the Framework Agreement.

15. The preamble and s. 1.1 of Exhibit "I" of the Framework Agreement read:

The Royalty Regulations 2003 (NL Reg. 71/03), as amended from time to time, enacted pursuant to the Petroleum and Natural Gas Act, RSNL 1990, c. P-10 (in this Exhibit the "Royalty Regulations") shall apply to the Growth Lands Project (and only respecting Oil), subject to the following:

1.1 The definitions of "basic royalty" (section 6), "gross revenue" (section 7), "simple payout" (section 9), "Tier I incremental royalty" (section 10), "Tier I payout" (section 10), "Tier II incremental royalty" (section 11), "net revenue" (section 12), "incidental revenue" (section 69) (all "the Crystallized Definitions"), the royalty rates and return allowance factors set out in Part XIV, and the eligible cost criteria set out in sections 63 through and including 66, and section 68 of the Royalty Regulations, as they existed on September 10, 2007, shall apply to the Growth Lands for the life of the Growth Lands Project. For greater certainty, this paragraph shall not apply to any term referred to in the Crystallized Definitions which is otherwise defined or described in the Royalty Regulations, unless expressly provided for in this Exhibit.

16. While s. 1.1 of Exhibit "I", read with the preamble, makes it clear that those sections of the Royalty Regulations are not to change for the life of the Growth Lands Project, in my view it also has the effect of making those sections applicable to the calculation of eligible costs for the Growth Lands Project and to the Growth Lands lease, and thus are relevant to the treatment of the Disputed Costs. In this respect, the royalty regime for the Growth Lands Project, as set out in the Framework Agreement, is inconsistent with the Royalty Regulations, as is permitted by s. 33 of the PNG Act. In such a case, the agreement, here the Framework Agreement, shall prevail.

17. S. 63(1) of the Royalty Regulations reads:

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63. (1) A cost shall qualify as an eligible pre-development cost, an eligible capital cost, an eligible operating cost or a decommissioning cost under a lease only to the extent that:

(a) it is a cash payment;

(b) it is directly attributable to exploration, development, production or decommissioning activities under the lease or was incurred to market oil produced under a lease provided that the marketing cost complies with paragraph 68(1)(f);

(c) it is reasonable in relation to the circumstances under which it is incurred;

(d) it is not a cost under another lease within Newfoundland and Labrador;

(e) with the exception of marketing costs, and insurance costs approved by the minister under this section, it is a cost that was incurred by the project operator and shared by all interest holders in the lease in proportion to their working interest share in the lease; and

(f) it meets all other requirements of these regulations.

18. Clearly, the Disputed Costs meet the criteria of s.s. (a) and (e). In my view the Disputed Costs also meet the criteria of s.s. (b), (c) and (f) because they were directly related to delineation and exploration in the Growth Lands and what became the Growth Lands Project, and it is common ground that the costs were reasonably incurred, and meet the other requirements in the regulations. In my view, in the particular and unusual circumstances of the creation of the Growth Lands lease by the Framework Agreement, the Disputed Costs were directly attributable to exploration, development and production under that lease. As my colleagues state "[T]he Disputed Costs were not eligible costs that relate or ever related to the Existing Lands".

19. I appreciate that the Province argues that double counting is dealt with and prohibited by s. 15(1) of the Royalty Regulations and therefore s. 63(1)(d) criteria cannot be met.
20. The Province argues that s. 63(1)(d) operates to prevent Disputed Costs from meeting the costs criteria in s. 63 because they were costs that had been claimed under another lease within Newfoundland and Labrador.

21. Section 15(1) reads:

15. (1) A cost or a part of a cost that has been claimed, deducted or included by an interest holder in a lease in the calculation of royalty share cannot be claimed, deducted or included by that interest holder or another interest holder in a calculation of royalty share under that lease or another lease.

22. It is of course the case that the Claimants did [S.39(2)] But that changed when the Framework Agreement came into being, as an agreement that was inconsistent with the Royalty Regulations, as permitted by the PNG Act s. 33. Once the "ring fence" was created and the Growth Lands lease became a separate lease, the Disputed Costs, which had been expended entirely on the lands covered in that lease, became, as I have said earlier, properly attributable as pre-development costs to the Growth Lands Project on the lands in the Growth Lands lease, by virtue of s. 1.1 of Exhibit "I" of the Framework Agreement, if they met the criteria in s.s. 63-66 of the Royalty Regulations. In my view, they did, and s. 15(1) had no application to that determination because Exhibit "I", entitled "Growth Lands Project Fiscal Terms" permitted that result.

23. The obvious purpose of s. 15(1) of the Royalty Regulations was to prevent double counting of costs, and that is also the purpose of s. 63.1(d). Once the Framework Agreement came into force, the Disputed Costs were no longer properly claimed or deducted under the Existing Lease or the White Rose Project Lease. Rather, applying s. 1.1 of Exhibit "I" of the Framework Agreement, they became eligible pre-development costs in the Growth Lands lease and for the Growth Lands Project and were properly so treated. Thus, the legislative purpose of s. 15(1) and s. 63(1)(d) was respected and fulfilled, since there was no double counting of the Disputed Costs.

24. With respect to s.s. (d) [S.39(2)
(and based on my colleagues' decision, subject to s. 59(5)(a) of the Royalty Regulations), the Disputed Costs could not be classified as a "cost under another lease". In my view, It is common ground that the

25. Thus, in my view, following the coming into force of the Framework Agreement on December 1, 2008, the Disputed Costs qualified as eligible pre-development costs under s. 63(1) of the Royalty Regulations for the Growth Lands lease and the Growth Lands Project, and the Claimants were entitled to so treat them.

Earl A. Cherniak, Q.C.

Toronto, Ontario
May 25, 2016