

Government of Alberta Takes Action to Address Unprecedented Price Differential

By Alicia Quesnel, Carolyn A. Wright, Evan W. Dixon, Brittney LaBranche, and Brendan Downey

On December 2, 2018, Premier Rachel Notley announced that, as of January 1, 2019, Alberta will curtail 325,000 barrels per day of raw crude oil and crude bitumen production. This figure represents approximately 8.7% of the province's daily production. Why?

According to the Government, producers within Alberta currently produce 190,000 more barrels of raw crude oil and crude bitumen per day than the province can export. With nowhere to go, these barrels enter storage at a faster rate than they leave, resulting in a supply overhang that has, in large part, been responsible for the outsized differential between Western Canadian Select and West Texas Intermediate oil contracts.

By scheduling the production cuts to begin in January 2019, the Government hopes to clear the oversupply within three months, at which point it expects that the mandatory rate of curtailment will drop to an estimated average of 95,000 barrels per day for the remainder of the calendar year. Despite these expectations, however, the Minister of Energy will retain the authority to adjust and set curtailment rates on a monthly basis as circumstances require. The Government hopes that this strategy will balance production with export capacity for the remainder of 2019, coinciding with the anticipated in-service date of the Enbridge Line 3 pipeline and the start of increased rail shipments.

Fast Take

- The Alberta Government has a broad statutory basis to order operators to curtail production
- Only raw crude oil and crude bitumen will be subject to curtailment; natural gas and condensates will not
- Curtailment orders will only impact operators producing in excess of 10,000 barrels per day
- The Minister will determine curtailment rates on a monthly basis
- Operators will have some discretion as to how and where they reduce their production levels to comply with any applicable curtailment orders
- If the crude oil or crude bitumen assets are jointly owned through a joint venture or partnership, the operator *may* enter agreements with the other owners to allocate permissible production levels among the participants
- Two or more operators that are subject to curtailment orders can apply to the Minister for a consolidation of their maximum production levels, or for a redistribution of maximum production levels among those party to the application
- In the event of non-compliance, the Alberta Energy Regulator (the Regulator) can assess administrative penalties of not more than \$5,000 per day

Can the Government do this? Authority for the Curtailment Order

On December 3, 2018, the Lieutenant Governor in Council of Alberta (Cabinet), approved Order in Council O.C. 375/2018 (OIC), enacting the *Curtailment Rules*¹ under the authority of the *Oil and Gas Conservation Act (OGCA)*, the *Oil Sands Conservation Act (OSCA)*, and the *Responsible Energy Development Act (REDA)*.²

Taken together, these Acts provide the Government—through Cabinet—with significant authority over Alberta's oil production. Perhaps most importantly, Section 68 of the *REDA* permits Cabinet to make "rules in respect of any matter for which the Regulator may make rules" under the *OGCA* and the *OSCA*. Accordingly, as long as the *OGCA* or the *OSCA* permit the Regulator to make certain rules, Cabinet can enact equivalent rules under the *REDA*'s rulemaking provisions. With respect to curtailment specifically, both the *OGCA* and the *OSCA* permit the Regulator to make rules for: i) the preservation of crude oil or crude bitumen resources within Alberta; and ii) the prevention of waste or the improvident disposition of crude oil or crude bitumen.³

In addition to this broad rulemaking authority, the *OGCA* allows the Regulator and therefore, Cabinet, to make rules governing the prorationing of crude oil production⁴, but any restrictions on production must be determined with respect to market demand for streams of crude oil within pipelines and allocated in a reasonable manner among the sources of supply that are subject to a prorationing order.⁵ The terms of the OIC do not make it clear whether Cabinet has relied upon this prorationing power, but the allocation mechanism contained in the Schedule to the *Curtailment Rules* appears to reflect these principles.

While the *OSCA* does not include any equivalent prorationing powers, Section 4 provides that any rule or order made under the *OSCA* overrides any term or condition of a contract or arrangement concerning the development of oil sands resources. This means that the *Curtailment Rules* and any order that directs mandatory curtailment rates can effectively override an approval and impose restrictions on oil sands production.

Section 2 of the *Curtailment Rules* provides that the purposes motivating this temporary regime are to:

- effect conservation and prevent wasteful operations;⁶
- prevent improvident disposition; and
- ensure the economical development in the public interest of the crude oil and crude bitumen resources of Alberta.

These statements of purpose echo the objects of both the *OGCA* and the *OSCA*, as well as the general guidance contained in the relevant rulemaking powers. The purposes of both the *OGCA* and the *OSCA* concern the conservation of petroleum resources, the prevention of waste, and the orderly, efficient, and economic development in the public interest of petroleum resources within Alberta.⁷ Moreover, the general rulemaking powers within each Act expressly permit the responsible authority to make rules that prevent the improvident disposition of crude oil and crude bitumen.

How will the *Curtailment Rules* Work?

Consistent with the Government's press release on December 2, the *Curtailment Rules* will only apply to crude oil and crude bitumen as those terms are defined in the *OGCA*.⁸ This means that natural gas production, as well as the production of condensates will not be subject to curtailment.

As of January 1, 2019, the Minister will have the authority to fix by order, "the combined provincial production allocation for a calendar month for crude oil and crude bitumen produced in Alberta."⁹ This approach seeks to ensure that all consequent curtailment rates will be determined and ordered¹⁰ with respect to a fixed maximum production value that will achieve the intended reductions in Alberta's current storage glut.

After the Minister fixes the combined provincial production allocation, she will then determine, for every month in which she will issue curtailment orders, the "baseline production" level of each operator.¹¹ This calculation measures the average number of barrels per calendar month each operator produced in the six greatest calendar months of production they achieved in the one-year period that commenced November 1, 2017.¹² There will be adjustments to this formula if the operator did not begin production until after April 30, 2018, or August 31, 2018, or produces less than 10,000 barrels per day.¹³

The Minister will then adjust each operator's baseline production by deducting a maximum allowable production rate of 10,000 barrels per day for each of the applicable days in the calendar month.¹⁴ The purpose of this adjustment is to shelter operators that produce less than 10,000 barrels per day from the curtailment regime.¹⁵

Once each operator's adjusted baseline production is identified, the Minister will determine the percentage of an operator's adjusted baseline production they will be allowed to produce for the next month. This number will be calculated by taking a ratio of the combined provincial production allocation and the aggregate of the adjusted baseline production for all operators in the province.¹⁶ As suggested above, using aggregate values determined on a province-wide basis in this manner will ensure that the curtailment orders apply in a consistent and reasonable manner to all operators that produce in excess of 10,000 barrels of crude oil or crude bitumen per day. It also means that larger operators can choose where to source their curtailment in a manner that most efficiently mitigates any negative impacts of a curtailment order. Finally, the Minister will determine the precise percentage of baseline production that each operator can produce that month without exceeding the combined provincial production allocation.¹⁷

Flexible Allocation and *Competition Act* Considerations

It should be clear from the above discussion that curtailment orders will apply to operators active in Alberta. Unfortunately, this operator-focused approach does not neatly correspond to the commercial reality in the oil patch. Many production sources are owned by multiple persons, whether through joint ventures or partnerships. If an operator is required to curtail production, it cannot curtail its own working share of production; all working interest owners will be curtailed on a pro rata basis.

To accommodate this commercial reality, the *Curtailment Rules* allow the parties to a joint venture or partnership to enter agreements that allocate the combined production of crude oil and crude bitumen amongst themselves to comply with a curtailment order. In effect, this rule permits the owners of jointly owned oil and gas assets to attribute all of the production associated with that joint venture or partnership to the operator.

In addition to these allocation agreements, the *Curtailment Rules* allow two or more operators, both of whom are subject to curtailment orders, to apply to the Minister for an order permitting a consolidation of the maximum amounts they can produce under a curtailment order. Operators can also apply to the Minister for an order to redistribute the amounts fixed under the curtailment orders amongst those operators seeking the order. These provisions could be of significant assistance to companies that own interests in several joint ventures or partnerships involved in the production of

crude oil and bitumen, but who may not be the operator to whom the curtailment order applies in each case.

These provisions raise the question: could such an arrangement be construed as an arrangement between competitors to fix or lessen the production or supply of a product (raw crude oil or bitumen) contrary to the criminal conspiracy provisions of Section 45 of the Competition Act? In short, probably not. Such an arrangement would likely be defensible under the "ancillary restraints" or "regulated conduct" defences, and it is unlikely that the Competition Bureau would pursue a criminal case against companies that engage in conduct that is expressly authorized by provincial legislation.

Penalties for Non-Compliance

Operators subject to curtailment orders cannot produce more than they are permitted.¹⁸ To ensure that the Regulator can enforce the curtailment orders, the *Curtailment Rules* amend the *Responsible Energy General Regulation*,¹⁹ empowering the Regulator to levy a maximum \$5,000 per day administrative penalty for each day an operator breaches an allocation order. This administrative penalty is in addition to the existing, more significant, penalties that may be available under the *OGCA* and the *OSCA* for breaches of the Rules enacted under each of those Acts.

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¹ *Curtailment Rules*, Alta Reg 214/2018.

² *Oil and Gas Conservation Act*, RSA 2000, c O-6, s 10 [OGCA]; *Oil Sands Conservation Act*, RSA 2000, c O-7, s 20 [OSCA]; *Responsible Energy Development Act*, SA 2012, c R-17.3, ss 68 and 70 [REDA].

³ OGCA, s 10(aaa); OSCA, s 20(u).

⁴ OGCA, ss 20(jj).

⁵ OGCA, ss 20(jj), 34.

⁶ The definition of "wasteful operations" in the OGCA and the OSCA includes the production of oil, gas, or bitumen "in excess of proper storage facilities or of transportation and marketing facilities or of market demand for it" (OGCA, s 1(1)(ddd); OSCA, s 1(1)(t)).

⁷ OGCA, s 4; OSCA, s 3.

⁸ *Curtailment Rules*, s 1(a), (b); OGCA, ss 1(1)(n), (o).

⁹ *Curtailment Rules*, s 4.

¹⁰ *Curtailment Rules*, s 5.

¹¹ *Curtailment Rules*, Schedule, s 1(1)(a).

¹² *Curtailment Rules*, Schedule, s 1(2).

¹³ *Curtailment Rules*, Schedule, ss 1(3), (4), 1(5), 8.

¹⁴ *Curtailment Rules*, Schedule, s 1(6).

¹⁵ *Curtailment Rules*, s 8.

¹⁶ *Curtailment Rules*, Schedule, s 2.

¹⁷ *Curtailment Rules*, Schedule, s 3.

¹⁸ *Curtailment Rules*, s 5(2).

¹⁹ *Responsible Energy General Regulation*, Alta Reg 90/2013.