

APPENDIX B2

THE CHAIR'S RECOMMENDATIONS

(includes all unanimous recommendations, all majority recommendations and recommendations made only by the Chair)

Offshore Revenue Threshold

- R1 Meaning of “derived from the production of petroleum”: The Panel recommends that in calculating the offshore revenue threshold, federal revenue “derived from the production of petroleum” should be interpreted to include federal revenue that is directly attributable to all activity within the ring fence in the production phase of any offshore project and arising after August 26, 1986 (the date of the 1986 Accord). This would include all federal revenue generated by the activities of project owners, their contractors, subcontractors, and the activities of suppliers and service companies delivering goods and services to the project during the production phase. Revenues derived from onshore economic activity stimulated by offshore activity (*i.e.* “spin-off activity”) should be excluded from federal revenue, unless they are on-shore activities that relate directly to enabling production in the offshore (such as on-shore fabrication of offshore equipment), in which case they should be considered to be within the ring fence.
- R2 Meaning of “derived from the production of petroleum”: The Chair and the Nova Scotia appointee recommend that federal revenue “derived from the production of petroleum” should, in addition to the federal revenue described in Recommendation #R1, include federal revenue that is directly attributable to the development phase of any offshore project, and with the same qualifications, inclusions and exclusions as are set out in Recommendation #R1, applied to the development phase.
- R5 Scope of Included Federal Revenues: The Panel recommends that the term “federal revenue” includes the following categories of revenues: federal corporate income tax, federal large corporations tax, customs and excise duties, federal sales taxes, and net harmonized sales taxes.
- R6 Scope of Included Federal Revenues: The Chair and the Nova Scotia appointee recommend that the term “federal revenue” also includes federal personal income tax on the employment income of individuals engaged in all activity in the production or development phase of a project, as set out in Recommendation #R1 and Recommendation #R2.
- R8 Meaning of “entitled”: The Panel recommends that any revenue to which the Province of Nova Scotia is ultimately entitled but which the federal government collects on behalf of Nova Scotia (*e.g.* provincial corporate income tax) should be excluded from federal revenue.

- R9 Meaning of “entitled”: The Chair and the Nova Scotia appointee recommend that the term “federal revenue” should include revenues to which Canada is ultimately entitled, whether received by Canada or not, but which it chooses to waive (*i.e.* through remission orders or otherwise) or to reduce through statutory relief (*i.e.* the Atlantic investment tax credit and any similar resource tax deductions, credits or exemptions).
- R11 Deferral v. Denial: The Chair and the Canada appointee recommend that Canada should have no obligation to make CSA Payments in respect of periods prior to the attainment of the offshore revenue threshold.

Threshold Rate of Return

- R13 Threshold Rate of Return: The Panel recommends adoption of the weighted average methodology submitted by Canada, modified as proposed by Nova Scotia. The threshold rate of return for any project should therefore be calculated by determining the weighted average of the effective yields on all debt instruments issued by the Province and outstanding during the 12 months prior to the conversion date, including any promissory notes, adjusted for the impact of any debt swap arrangements in effect in such period.

Project Rate of Return

- R14 Conversion Date: The Chair and the Canada appointee recommend that the conversion date for any project is the date of approval of the development plan for that project under Section 143 of the 1988 Act, such that Nova Scotia is responsible for its share of project costs after this date.
- R16 Revenue Projections: The Panel recommends that revenue projections for SOEP and Deep Panuke be based on the revenue projections submitted to the Panel by Nova Scotia, as supplemented by any further information that further increases the reliability of SOEP revenue projections.
- R17 Eligible Costs: The Chair and the Nova Scotia appointee recommend that eligible costs do not survive the termination of the petroleum incentive program, and that eligible costs are only included as a Schedule IV cost to the extent that the federal government actually paid PIP grants in relation to such eligible costs.
- R19 Provincial Share: The Chair and the Nova Scotia appointee recommend adoption of Nova Scotia’s position that the “provincial portion” is 12.5 per cent in the case of a gas project or 6.25 per cent in the case of an oil project. The Nova Scotia appointee notes that the effect of this recommendation is that Nova Scotia is paying the costs attributable to its 12.5% share of a gas project and its 6.25% share of an oil project.
- R21 Interest on PIP Grants: The Panel recommends that no interest be charged to Nova Scotia in respect of those PIP grants paid by Canada that were subsequently refunded to Canada by the grant recipient.

- R22 Ex Gratia Payments: The Chair and the Nova Scotia appointee recommend that *ex gratia* payments not be included in determining CSA Payments except to the extent that it can be shown that such payments were actually made in respect of a field.
- R24 Project Rate of Return: The Panel recommends that the rate of return for a project be calculated using projected cash flows from the same categories of revenues and costs as are used in the deemed profit calculation (see Recommendations #R26 to #R28, #R33 to #R40 and #R43), but using projected revenues and costs and excluding interest costs on financing the provincial capital loan.
- R25 Project Rate of Return: The Panel recommends that a project's rates of return be calculated by discounting all project cash flows at the threshold rate of return. If the result is positive, the project passes the threshold. If the result is negative, the threshold has not been met.

Deemed Profit

- R26 Individual Owner Costs: The Chair recommends that individual owner costs other than federal income taxes be included. Specifically, the Chair recommends that interest expense on the provincial capital loan, provincial royalties and provincial income taxes be included.
- R29 Cumulative or Discrete Calculation: The Chair recommends that deemed profit be calculated on a cumulative basis until the point at which development costs have been recouped, and thereafter deemed profit should be calculated on a discrete year by year basis.
- R32 Revenue: The Panel recommends that project revenues for purposes of calculating deemed profit should be as reported to the Province pursuant to the *Offshore Petroleum Royalty Act* (Nova Scotia), S.N.S. 1987, c.9 as amended from time to time, recognizing that Nova Scotia may amend its royalty legislation in the future.
- R33 Schedule IV Interest (Prior to Conversion Date): The Chair and Canada's appointee recommend that acquisition costs should be adjusted for interest prior to the date of conversion using the 1 per cent per month interest factor as set out in Schedule IV to the 1982 Agreement as amended by Article 45.03 of the 1986 Accord.
- R35 Schedule IV Interest (After Conversion): The Panel recommends that the "government borrowing rate" to be applied to Nova Scotia's obligation to pay acquisition costs to Canada after the date of conversion should be a floating rate equal to the annual weighted average long term borrowing rate of the Government of Canada.
- R36 Schedule IV Interest: The Panel recommends that interest on acquisition costs both before and after the date of conversion should be calculated using simple

interest, without compounding.

- R37 Interest on Capital Loans (Borrowing Rate): The Chair and the Canada appointee recommend that interest costs on any provincial capital loan should be calculated using a borrowing rate calculated on the same basis as for determining the province's cost of borrowing under the Threshold Rate of Return section above (see Recommendation #R13).
- R39 Interest on Capital Loans (Compounding): The Chair and the Canada appointee recommend that interest costs on any provincial capital loan should be calculated with interest compounded annually.
- R41 Capital Costs for Glenelg: The Chair and the Nova Scotia appointee recommend that acquisition costs or capital costs associated with the Glenelg field of SOEP after its date of conversion be excluded in calculating deemed profit in respect of SOEP.
- R43 Net Production Revenues: The Panel recommends that "net production revenues" means production revenues less operating costs, capital costs and provincial royalties. The Province's interest costs and income taxes should not be deducted in arriving at "net production revenues".

Reduction for Fiscal Incentives

- R44 Fiscal Incentives: The Panel concludes that there have to date been no fiscal incentives that impact on CSA Payments.

Time and Manner of Payment

- R45 Annual Payment: The Panel recommends that CSA Payments be made annually on a per project basis, based on the twelve-month fiscal period from April 1 to March 31 each year, and that such payment be made no later than September 30 after the end of such fiscal period. To the extent data necessary to calculate CSA Payments in any fiscal year are readily available only on a calendar year basis, then the data for the calendar year ending in the particular April 1 to March 31 fiscal year should be used in computing CSA Payments for such fiscal year.
- R46 Recovery of Overpayments: The Panel recommends there be no recoveries (*i.e.* clawbacks) applied in the event of subsequent determination of overpayment to Nova Scotia, including any overpayments arising from reassessment of provincial royalty return data under Nova Scotia's royalties regime, but that overpayments be instead deducted from subsequent payments.
- R47 Interest: The Chair and the Nova Scotia appointee recommend that Canada compensate Nova Scotia with interest, or by payment in lieu thereof, on CSA Payments for years prior to the fiscal year ending March 31, 2008. The recommended interest rate to be applied in determining such compensation is Nova Scotia's borrowing rate calculated in the manner recommended for

determining the Province's cost of borrowing under the Threshold Rate of Return section above (see Recommendation #R13), without compounding. This recommendation is made on the basis of fairness and without attribution of fault for any delay in the making of CSA Payments.