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# Financial Responsibility Requirements for Oil And Gas Activities Offshore Nova Scotia and Newfoundland

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# Financial Responsibility Requirements for Oil And Gas Activities Offshore Nova Scotia and Newfoundland

*This article outlines the regime of statutory liability and financial responsibility requirements for the Nova Scotia and Newfoundland offshore areas with a particular emphasis on the content and validity of the Nova Scotia and Newfoundland Boards' jointly issued Guidelines for Financial Responsibility.*

*Cet article décrit le régime de responsabilité statutaire (responsabilité financière) régissant le secteur de l'exploitation pétrolière en mer en Nouvelle-Écosse et parallèlement, le régime régissant ce même secteur à Terre-Neuve. L'auteur analyse les lois ayant donné naissance au régime actuel en s'attardant sur la teneur et la validité des lignes directrices relatives à la responsabilité financière des exploitants établies en concertation par les offices d'exploration pétrolière et gazière extracôtière de la Nouvelle-Écosse et de Terre-Neuve.*

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## *Introduction*

The purpose of this article is to outline the essential elements of the statutory liability scheme applicable to oil and gas operations in the offshore areas of Nova Scotia and Newfoundland, as well as the administrative requirements in respect of financial responsibility. Oil and gas exploration and production activities in the offshore areas of Nova Scotia and Newfoundland are governed by federal and provincial legislation enacted to implement political accords between each province and the federal government. The Nova Scotia and Newfoundland accords and the legislation implementing them are similar. These accords were imple-

mented by enacting essentially identical federal and provincial legislation, thereby avoiding the issue of whether the federal government or the province had jurisdiction in each case.[1]

The accords provide that offshore oil and gas resources will be managed jointly by the federal and provincial governments through boards established under the *Accord Acts*. The board having management and administrative responsibility for the Nova Scotia offshore area[2] is the Canada-Nova Scotia Offshore Petroleum Board (Nova Scotia Board, or Board). The corresponding board for the Newfoundland offshore area is the Canada-Newfoundland Offshore Petroleum Board (Newfoundland Board; the Newfoundland Board and the Nova Scotia Board are together referred to as the Boards).

## I. Liability

Civil liability for damage from offshore oil and gas operations can arise under common law and statute. A discussion of the common law is beyond the scope of this article, but the scheme of statutory liability under the *Nova Scotia Accord Act* will be briefly described, as it is the main basis for the financial responsibility requirements. Liability can also arise under contract, for example under voluntary compensation plans adopted by industry or as a result of licence conditions or conditions of approval.

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1. For the Nova Scotia offshore area: *Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act*, S.C. 1988, c. 28 [hereinafter the *Nova Scotia Accord Act*], and *Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation (Nova Scotia) Act*, S.N.S. 1987, c. 3. For the Newfoundland offshore area: *Canada-Newfoundland Atlantic Accord Implementation Act*, S.C. 1987, c. 3, and *The Canada-Newfoundland Atlantic Accord Implementation (Newfoundland) Act*, S.N. 1986, c. 37. For brevity, this article will reference only the federal act applicable to the Nova Scotia offshore area, the *Nova Scotia Accord Act*, and the regulations thereunder. However, the corresponding sections of the federal Act and regulations applicable to the Newfoundland offshore area are essentially the same, as are the corresponding sections of each of the provincial acts and regulations. (The federal and provincial versions of the Nova Scotia and Newfoundland Acts are herein collectively referred to as the *Accord Acts*.)

2. The limits of the Nova Scotia offshore area are described in Schedule I to the *Nova Scotia Accord Act*, *ibid.* Newfoundland has challenged the boundary between Newfoundland and Nova Scotia as set out in the *Nova Scotia Accord Act* and this dispute is currently proceeding to arbitration.

1. *Statutory Liability*

Statutory liability for damage resulting from offshore oil and gas operations arises primarily under the *Nova Scotia Accord Act*, although the *Fisheries Act*[3] also provides for civil liability if deleterious substances are deposited in waters "frequented by fish" without authorization.[4] Part XVI of the *Canada Shipping Act*[5] provides for civil liability for oil pollution from ships, but this Part is generally inapplicable to oil and gas operations.[6]

The *Nova Scotia Accord Act* deals specifically with liability for spills[7] and debris.[8] It provides that where a spill occurs in any portion of the offshore area,

> the person who is required to obtain an authorization . . . in respect of the work or activity from which the spill . . . emanated is liable, without proof of fault or negligence, up to any prescribed limit of liability for
>
> (i) all actual loss or damage incurred by any person as a result of the spill . . . and
>
> (ii) the costs and expenses reasonably incurred by the Board or Her Majesty in right of Canada or the Province or any other person in taking any action or measure in relation to the spill . . . .[9]

The *Nova Scotia Accord Act* therefore makes the operator absolutely liable for spills up to a prescribed limit, which is currently $30 million.[10] Unlike the *Fisheries Act*, which provides for limited defences to its absolute liability provisions, there are no statutory defences to the

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3. R.S.C. 1985, c. F-14.
4. *Ibid.*, s. 36(3).
5. R.S.C. 1985, c. S-9.
6. *Ibid.*, s. 674(2) provides that Part XVI does not apply to "a drilling ship that is on location and engaged in the exploration or exploitation of the sea-bed or its subsoil, in so far as the discharge of the pollutant emanates from those activities."
7. "Spill" is defined in *Nova Scotia Accord Act*, *supra* note 1, s. 165(1), as a discharge, emission or escape of "petroleum" (defined in s. 2 as essentially crude oil or natural gas) other than an authorized discharge, emission or escape, or a discharge of a pollutant caused by or otherwise attributable to a ship (in respect of which the *Canada Shipping Act* applies).
8. "Debris" is defined in the *Nova Scotia Accord Act*, *ibid.*, s. 165(2), as "any installation or structure that was put in place in the course of any work or activity required to be authorized under paragraph 142(1)(b) and that has been abandoned without such authorization as may be required by or pursuant to this Part, or any material that has broken away or been jettisoned or displaced in the course of any such work or activity."
9. *Ibid.*, s. 167.
10. *Canada-Nova Scotia Oil and Gas Spills and Debris Liability Regulations*, S.O.R./95-123

absolute liability provisions in the *Nova Scotia Accord Act*. In addition, the *Nova Scotia Accord Act* provides for unlimited liability to the extent that negligence or fault can be shown:[11]

> all persons to whose fault or negligence the spill . . . is attributable or who are by law responsible for others to whose fault or negligence the spill . . . is attributable are jointly and severally liable, to the extent determined according to the degree of the fault or negligence proved against them, for all actual loss or damage incurred by any person as a result of the spill . . .[12]

Similar provisions apply with respect to debris.[13] "Actual loss or damage" is defined to include loss of income, including future income, and, with respect to any aboriginal peoples of Canada, loss of hunting, fishing and gathering opportunities.[14]

The *Nova Scotia Accord Act* specifically provides that these liability provisions do not suspend or limit (a) any legal liability or remedy for an act or omission by reason only that the act or omission gives rise to liability under these provisions, (b) any recourse, indemnity or relief available at law to a person who is liable under these provisions against any other person, or (c) the operation of any applicable law or rule of law that is not inconsistent with these provisions.[15]

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11. The liability provisions of the *Nova Scotia Accord Act*, *supra* note 1, as originally passed in 1988 made an operator absolutely liable for oil spills and debris attributable to his work or activity up to the prescribed limit (whether or not the operator was negligent or at fault) and in addition made the operator liable potentially beyond that limit to the extent that negligence or fault could be shown, together with any other parties who were negligent or at fault. Since the paragraphs dealing with fault or negligence did not limit liability to the prescribed limit, and since those paragraphs referred to "all" actual loss or damage, it was generally accepted that liability was unlimited in cases of fault or negligence.
However, in 1992 the *Nova Scotia Accord Act* was amended to add s. 167(2.1). This provides that where the statutory liability provisions apply, no person will be liable for more than the greater of the prescribed limit for absolute liability for spills or debris ($30 million) and the amount for which the person would be liable under any other law for the same occurrence. This subsection is not limited to the paragraphs dealing with absolute liability but applies to all of s. 167(1) and (2), including the paragraphs creating liability in cases of fault or negligence. The limitation of liability even in cases of fault or negligence would appear to be a drafting error; it is suggested that the reference to "subsection (1) or (2)" should read "paragraph (1)(a) or (2)(a)" (the absolute liability provisions). It appears from the marginal heading that the purpose of this amendment was merely to prevent double liability.
12. *Ibid.*, s. 167(1)(b).
13. *Ibid.*, s. 167(2).
14. *Ibid.*, s. 165(3).
15. *Ibid.*, s. 167(4).

### 2. *Liability and Indemnity Provisions in Licence Documents*

Despite the fact that the Nova Scotia and Newfoundland *Accord Acts* address liability, both Boards include related provisions in their licences. The practice of the two Boards is different in this regard; although both Boards include a clause in their exploration licences providing for an indemnity in favour of the Board and the federal and provincial governments,[16] the Newfoundland form of exploration licence has an additional clause specifically making all interest holders in a licence liable for damages arising out of work conducted on the licence "by, through, or under, or with the consent of" the interest holder. A full discussion of these provisions is beyond the scope of this article. However, a couple of observations will be made.

First, there is an issue concerning the validity of these provisions. There is no direct authority in the *Nova Scotia Accord Act* for including liability and indemnity provisions in licences.[17] Section 70 provides that an exploration licence shall contain such terms and conditions as may be prescribed by regulation, however, no such regulation has been promulgated. It is arguable that since the issue of liability is already addressed in the *Nova Scotia Accord Act*, presumably comprehensively, it beyond the power of the Board to modify or even to supplement the statutory scheme. The technique used by the Board to overcome this potential objection is to obtain the deemed agreement of the interest holders to the terms and conditions of the licence.[18] This is done by specifically providing in each call for bids that the submission of a bid shall constitute agreement to the terms and conditions set out in the form of exploration licence.[19]

The second observation is that in addition to modifying and supplementing the liability provisions applicable to the operator, the inclusion of these provisions in exploration licences imposes liability on the interest holders. The liability provisions of the *Nova Scotia Accord Act* are contained in Part III, which deals generally with operational matters. There are no similar provisions in Part II, which deals with rights to explore for and produce oil and gas. There is nothing in the *Nova Scotia*

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16. For the wording currently used by the Newfoundland Board, see the sample exploration licence attached to Call for Bids NF00-1, closing November 15, 2000. For the wording used by the Nova Scotia Board, see the sample exploration licence attached to Call for Bids NS00-1, dated June 29, 2000 and closing October 30, 2000.

17. Although s. 58(2) of the *Nova Scotia Accord Act*, *supra* note 1, contemplates that an interest owner or interest holder may be liable to the Crown by way of indemnity.

18. Section 70(1) provides that an exploration licence may contain other terms and conditions agreed on by the Board and the interest owner.

19. See *e.g.* para. 3 of Call for Bids NS00-1 dated June 29, 2000 and closing October 30, 2000.

*Accord Act* that imposes liability on an interest holder simply because it is an interest holder. Of course, an interest holder could be liable at common law, or could be liable if it is also the operator, or is at fault or negligent. However, the drafters of the legislation apparently considered the question of liability and saw fit to confine these provisions to Part III, which deals with operations and is generally directed at persons authorized to conduct works and activities. It is operations that will potentially result in damage, not the mere status as an interest holder.

## II. *Statutory Requirements Relating to Financial Responsibility*

Financial responsibility requirements for oil and gas operations are contained in the *Nova Scotia Accord Act*, the *Nova Scotia Offshore Petroleum Drilling Regulations*[20] and the *Nova Scotia Offshore Area Petroleum Production and Conservation Regulations*.[21]

### 1. *Nova Scotia Accord Act*

The *Nova Scotia Accord Act* provides that an applicant for an authorization "in respect of any work or activity in any portion of the offshore area shall provide proof of financial responsibility in the form of a letter of credit, a guarantee or indemnity bond or in any other form satisfactory to the Board, in an amount satisfactory to the Board."[22] The holder of an authorization must ensure that the proof of financial responsibility remains in force for the duration of the work or activity in respect of which the authorization is issued.[23]

The Board may pay out funds available under this security in respect of any claim for which proceedings may be instituted under the statutory liability provisions dealing with spills and debris, whether or not such proceedings have in fact been instituted.[24] Such payments may not exceed the amount prescribed for any case or class of cases, or determined by the Board in the absence of regulations. If a claim is sued for under the liability provisions of the *Nova Scotia Accord Act*, the amount of any such compensation payments received by the claimant is deducted from the award made pursuant to the action in respect of the same loss.[25] This is all supposed to be monitored by and subject to the review of a statutory

20. S.O.R./92-676 [hereinafter *Drilling Regulations*].
21. S.O.R./95-190.
22. *Nova Scotia Accord Act*, *supra* note 1, s. 168(1).
23. *Ibid.*, s. 168(1.1).
24. *Ibid.*, s. 168(2).
25. *Ibid.*, s. 168(3).

committee consisting of members appointed by the federal and provincial governments and by representatives of the petroleum and fisheries industries, although no such committee has been set up.[26]

The *Nova Scotia Accord Act* also provides that in authorizing any work or activity, the Board may make its authorization subject to "such requirements and deposits as the Board determines or as may be prescribed, including (a) requirements relating to liability for loss, damage, costs or expenses . . . ."[27]

2. *Regulations*

The *Drilling Regulations* provide that

> [e]very operator shall, prior to drilling or re-entering a well,
>
> (a) furnish the Board with evidence of financial responsibility in a form and in an amount satisfactory to the Board or any person designated by the Board, for the purpose of ensuring that the operator terminates the well and leaves the drill site in a satisfactory condition in accordance with section 180;[28] and
>
> (b) furnish the Board with evidence, in a form satisfactory to the Board or any person designated by the Board, that the operator is financially able to meet any financial liability that may be incurred as a result of the drilling of a well or of any operation in the well.[29]

It will be noted that the "evidence of financial responsibility" referred to in paragraph (a) above is intended to operate as a guarantee ("for the purpose of *ensuring*") while the "evidence" referred to in paragraph (b) appears to merely require a demonstration that the operator is able to meet its financial liabilities.

The *Nova Scotia Offshore Area Petroleum Production and Conservation Regulations* provide as follows:

> 10. For the purposes of subsection 142(4) of the Act and in respect of an authorization issued pursuant to paragraph 142(1)(b) of the Act to carry on a work or activity in relation to the development of a pool or field or the production of petroleum, the operator shall, before the work or activity is started, submit to the Board

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26. *Ibid.*, s. 169.
27. *Ibid.*, s. 142(4).
28. Section 180 relates to abandonment and provides that "[e]very operator shall ensure that on the termination of any well the seafloor is cleared of any material or equipment that could interfere with other commercial uses of the sea, unless the Board or any person designated by the Board, having been satisfied that no interference with the commercial use of the sea is reasonably likely to result, otherwise approves."
29. *Supra* note 20, s. 72.

(a) evidence of financial responsibility, of a type and in an amount that is sufficient to ensure that the operator

(i) completes the work or activity, and

(ii) leaves the site where the work or activity was carried on in the state required by Part VII or by the Board pursuant to subsection 142(4) of the Act; and

(b) evidence that the operator is able to meet any financial liability that might be incurred in connection with the work or activity.[30]

As with the *Drilling Regulations*, the "evidence of financial responsibility" referred to in paragraph (a) is intended to operate as a guarantee while the "evidence" referred to in paragraph (b) goes to the ability of the operator to meet financial liabilities.

### III. *Financial Responsibility Guidelines*

Both the *Nova Scotia Accord Act* and the regulations provide that the required evidence of financial responsibility shall be in a form and in an amount satisfactory to the Board. In 1992, the Nova Scotia Board and the Newfoundland Board jointly issued guidelines outlining the requirements of both Boards with respect to drilling operations.[31] In May 1999, following more than a year of consultation with industry, the two Boards jointly released revised guidelines intended to address financial responsibility requirements for *all* works and activities in the Newfoundland and Nova Scotia offshore areas (instead of just drilling operations).[32] Certain issues arising from these guidelines were never resolved with industry and are still the subject of discussions between the Canadian Association of Petroleum Producers (CAPP) and the Boards. The Boards have indicated that they will be making further revisions to these guidelines in the near future as a result of these discussions.

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30. *Supra* note 21, s. 10.

31. Canada-Nova Scotia Offshore Petroleum Board and Canada-Newfoundland Offshore Petroleum Board, *Guidelines Respecting Financial Responsibility Requirements for Drilling in the Newfoundland and Nova Scotia Offshore Areas* (February 1992) [hereinafter *1992 Guidelines*].

32. Canada-Nova Scotia Offshore Petroleum Board and Canada-Newfoundland Offshore Petroleum Board, *Guidelines Respecting Financial Responsibility Requirements for Work or Activity in the Newfoundland and Nova Scotia Offshore Areas* (May 1999) [hereinafter *Guidelines*]. The *Guidelines* are posted on the websites of each Board, online: Canada-Nova Scotia Offshore Petroleum Board homepage <http://www.cnsopb.ns.ca> (date accessed: 26 July 2001); online Canada-Newfoundland Offshore Petroleum Board homepage <http://www.cnopb.nf.net> (last modified: 24 July 2001). The Guidelines were revised in December 2000, after this article was written.

Since the *Guidelines* reflect the current requirements of the Boards, their main features will be described, followed by a discussion of a number of issues arising out of them. The *Guidelines* deal separately with the following activities: drilling, development or production, decommissioning and other activities such as geophysical operations.

1. *Drilling*

There are three types of financial security or evidence of financial responsibility that the Board will require before authorizing drilling operations. The first is financial security which will give the Board immediate, unfettered and direct access to cash to enable the Board to settle claims or to cover the costs of remedial action. This is the evidence that operates as a guarantee. It is typically provided by a letter of credit in the form attached to the *Guidelines*, but other instruments may be acceptable as well, including a guarantee by a financial institution, an indemnity bond, marketable securities, or some other arrangement acceptable to the Board. Insurance or evidence of financial capability will not be accepted for this purpose because this type of security does not afford immediate and direct access to cash; in the case of insurance, for example, the insurer may raise defences to a claim and in any case there may not be an immediate settlement. The Board will generally require this type of security in an amount equal to the prescribed limit of absolute liability, *i.e.*, $30 million. This was the only type of security discussed in the *1992 Guidelines*.[33]

Second, in addition to security which provides immediate, unfettered and direct access, the Board will also require an additional $70 million of further security that provides an enforceable commitment or mechanism by which the Board can obtain funds directly, although not necessarily immediately. Including the first $30 million, the Board may therefore require up to $100 million of security which it can access directly. The $70 million layer may be satisfied by insurance which names the Board as an insured party, giving it direct access to the proceeds of insurance. Alternatively, if a company has chosen to self-insure or does not want to modify its insurance program to add the Board as a named insured or to meet the other requirements of the Board with respect to insurance, the

33. The *1992 Guidelines* state that the evidence of financial responsibility required by the *Accord Acts* "relates to liability for which proof of fault or negligence is not necessary, and is required to provide a source of funds as a contingency against claims resulting from seafloor debris or a petroleum spill." The *1992 Guidelines* accordingly provide that the evidence of financial responsibility must be in the amount of the prescribed limit of liability and must be in a form that affords access by the Boards for the purposes of claims settlement.

Board may accept a promissory note from the company (or its parent or other affiliate) supported by a current audited financial statement evidencing the company's ability to pay the note. A company may also satisfy the requirements for the $70 million layer with the types of security acceptable for the first $30 million layer.

The third type of security applies to amounts above $100 million. The Board does not require a right of direct access to funds above $100 million; to the extent that evidence of financial responsibility is required above this amount, a company is merely required to demonstrate that it has the financial capability to meet any liabilities up to the following limits:

- removal of debris: up to 25 percent of the reinstatement cost of the property
- liabilities to third parties: up to $200 million
- well control, making wells safe, pollution clean up: up to $250 million

These limits are on top of the $100 million direct access security. This third category of evidence may be insurance, an audited financial statement, a guarantee from a third party, including an affiliate, a letter of credit or indemnity bond, or some other form of security or evidence of financial responsibility acceptable to the Board. If insurance is used, deductible amounts must be approved by the Board. In addition, the *Guidelines* also require an operator to provide the Board with an indemnity agreement. This requirement is discussed further below.

2. *Development or Production*

A development program will include a number of separate activities requiring work authorizations. The *Guidelines* indicate that an operator can deal with financial responsibility requirements one application at a time, or alternatively a single package of documentation can be filed which will apply to all authorizations that are contemplated for the entire development or for particular phases of the development.

The type of evidence of financial responsibility required will depend on the nature of the activities. For drilling and production activities, the same requirements set out above would apply. For other activities, the *Guidelines* state that the operator must demonstrate that it is able to meet any financial liability that may arise out of the work or activity, for example through insurance. An indemnity agreement is also required. Evidence of financial responsibility will also be required to ensure that the work or activity is properly terminated and that the site is left in satisfactory condition.

### 3. *Decommissioning of a Production Installation*

The *Guidelines* state that, since each project and production installation is unique, requirements respecting evidence of financial responsibility will be dealt with on a case-by-case basis. One interesting feature of this section is a requirement that the operator must include "the manner and form in which any residual liability will be dealt with by the operator and interest owner, in the event any subsequent claims arise after such abandonment/decommissioning occurs, with respect to damages attributable to the operator's work or activity."

### 4. *Other Work or Activity*

Other work or activity includes things such as geological, geophysical or geotechnical programs, environmental programs and diving programs. For these activities, the *Guidelines* require that the operator demonstrate the ability to satisfy liabilities for: claims by any person relating to loss or damage to property, financial loss or injury or death; and claims by any person relating to the restoration and preservation of the natural environment, including the seabed. No limits are specified.

The *Guidelines* suggest that the form of such evidence could be insurance, an audited financial statement, a corporate guarantee from a third party, including an affiliate, a letter of credit or indemnity bond or some other acceptable form. There is no requirement for security giving immediate and direct access to cash.

## IV. *Issues*

### 1. *Validity of Guidelines*

There is no specific statutory authority for the *Guidelines*. The *Nova Scotia Accord Act* provides that the Board may issue and publish guidelines and interpretation notes with respect to the application and administration of s. 45 (benefits plans), s. 142 (work authorizations) and s. 143 (development plans), and any regulations made under s. 153 (regulations relating to operations).[34] The *Guidelines* arguably relate to work authorizations, as an authorization may not be issued until the required financial security is in place.[35]

The limits that can be placed on policy statements issued by a regulatory tribunal were recently considered in *Ainsley Financial Corp.* v. *Ontario (Ontario Securities Commission)*.[36] In that case the Ontario Court of Appeal found that a policy statement issued by the Ontario

34. *Nova Scotia Accord Act*, *supra* note 1, s. 156.
35. *Ibid.*, s. 142.3.
36. (1994), 28 Admin. L.R. (2d) 1, 21 O.R. (3d) 104, 21 D.L.R. (4th) 79 (C.A.).

Securities Commission had a mandatory character and amounted to an attempt to impose a *de facto* legislative scheme, complete with detailed substantive requirements. The court held that the commission could not impose such a scheme without the appropriate statutory authority and that such policy statements must be like guidelines — intended to provide guidance but without binding effect:

> a non-statutory instrument cannot impose mandatory requirements enforceable by sanction; that is, the regulator cannot issue de facto laws disguised as guidelines. The decision of Mr. Justice Iacobucci in the *Pezim* case is quoted as authority for that proposition, and particularly his statement that "by that I mean that their policies cannot be elevated to the status of law . . . .[37]

If a regulator applies its own guidelines and policies in an automatic manner, the regulator may be binding itself instead of judging each case on its own merits. This also effectively elevates guidelines and policies to the "status of law." This case has been criticized as having taken an unduly narrow view of the role of regulatory tribunals.[38] In any case, with respect to financial responsibility requirements, the Boards have so far not applied any requirements automatically, and it would appear that the *Guidelines* would not offend *Ainsley*.

2. *Permitted Purposes of Financial Security*

The *1992 Guidelines* provided that evidence of financial responsibility was required only for purposes of the absolute liability provisions. These guidelines were issued in February 1992, before the June 1992 amendments to the *Nova Scotia Accord Act*.[39] Before these amendments were made, s. 168(1) of the *Nova Scotia Accord Act* referred to "financial responsibility for the purposes of subsections (2) and (3)" (which provide for the payment of claims in respect of spills or debris). The present language simply requires proof of financial responsibility, and does not expressly limit its purpose to the payment of claims in respect of spills or debris under s. 67.

If the present language had not resulted from an amendment, it might be arguable that because the rest of s. 168 deals with spills and debris, s. 168(1) should be interpreted in this context. However, the amendment would more likely be interpreted as deliberately expanding the purpose of financial security beyond spills and debris. Reading this section together with s. 142(4) and the financial responsibility provisions of the

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37. *Ibid.*, at 7 (Admin. L.R.).
38. See A. J. Roman, Case Comment (1996) 32 Admin. L.R. (2d) 28.
39. *An Act to amend the Oil and Gas Production and Conservation Act and other Acts in consequence thereof*, S.C. 1992, c. 35.

regulations, discussed above, it would seem that the Board may now require financial security for other purposes, for example to secure the payment of costs claimed by the Board to properly abandon a well in circumstances where the claim does not amount to a claim for debris.

3. *Direct Access to Funds*

The *Nova Scotia Accord Act* provides that the Board "may require that moneys . . . be paid out of the amount available under the letter of credit, guarantee or indemnity bond or other form of financial responsibility . . . in respect of any claim for which proceedings may be instituted under section 167, whether or not such proceedings have been instituted."[40] The wording of this provision suggests that the Board does not need to have direct access to the funds itself; otherwise, it would have stated that the Board itself may pay claims. Instead, it merely enables the Board to "require" payment. However, there is nothing that prohibits the Board from requiring direct access and the examples of acceptable security listed in s. 168(1), *i.e.*, a letter of credit, guarantee or indemnity bond, are instruments of direct access. Since other forms of financial security need to be "satisfactory" to the Board, and since the amount of the security is in the discretion of the Board, the Board would appear to have the discretion to require security that provides for direct access in any amount that it deems fit, without regard to the $30 million amount prescribed as the limit for absolute liability.

However, even if the Board has the authority to require security that gives it direct access to funds, it does not necessarily follow that the Board may pay out funds in all cases without a court order. Section 168(2) is the only provision in the *Nova Scotia Accord Act* giving the Board authority to pay out funds available under the financial security, and is limited to claims which may be made under s. 167, *i.e.*, claims for spills and debris. Section 167 includes claims for spills or debris in excess of the absolute liability limit based on fault or negligence. However, the Board itself is not competent to determine whether or not fault or negligence exists. Therefore, in making payments out of funds available under the financial security, the Board will be limited to claims for spills or debris having an aggregate amount within the limit of absolute liability.

Furthermore, s. 167(3) provides for priority between claims for actual loss or damage from spills or debris, which rank first, and claims for costs and expenses, including costs incurred by the Board or governments, which rank second. Accordingly, if there is the potential for aggregate

40. *Nova Scotia Accord Act*, *supra* note 1, s. 168(2).

claims to exceed $30 million, the Board may not be able to immediately use the financial security to pay for remedial action in cases of spills or debris.

In the absence of a provision giving the Board authority to pay out funds in respect of other obligations, such as obligations related to decommissioning, there would seem to be little reason for the Board to require direct and immediate access to funds. Assuming that a court order will be required in such cases, it should be sufficient for an operator to provide evidence of financial capability.

4. *Requirement for Indemnity Agreement*

One of the main features of the *Guidelines* that industry has objected to is the requirement that the operator provide the Board with an indemnity agreement as agent for the "participating interest holders." The form of the indemnity agreement is attached to the *Guidelines* and contains the following provision:

> 2. In the event any injury, death, damage to property or to the environment occurs as a result of any work or activity conducted in relation to the Authorization, the Operator, as agent for the above participating parties and interest holders, shall indemnify the Board, the Chief Conservation Officer and any person delegated by the Board or directed by the Chief Conservation Officer pursuant to the legislation, from and against any costs, claims, liabilities and expenses that may arise with respect to such injury, death or damage, except to the extent of any negligence or wilful misconduct by or on behalf of the Board, Chief Conservation Officer or such delegate.[41]

The *Guidelines* state that "[t]he purpose of the indemnity agreement is to provide the assurance to the Board that the operator, as agent for and together with the parties and interest holders participating in the work or activity, will indemnify the Board and others, should the other evidence of financial responsibility be insufficient or otherwise fail to do so. Consequently the indemnity agreement is intended to be used as a last resort remedy." This is expressed in the indemnity agreement itself as follows:

> 4. The rights of the Board, the Chief Conservation Officer and delegates, with respect to this Indemnity Agreement shall be in addition to any other rights of the Board, its members and employees, arising from any other evidence of financial responsibility submitted by the Operator, which rights shall only be exercised through this Indemnity Agreement as a last resort in the event the other evidence of financial responsibility provided by the Operator fails to provide such indemnity.[42]

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41. *Supra* note 32.
42. *Ibid.*

The stated purpose is confusing, because the indemnity agreement is fundamentally different from other evidence of financial responsibility, such as a letter of credit or insurance; it does not provide evidence of an operator's ability to satisfy its own liabilities, but rather protects the Board from liability.[43] It therefore imposes additional liabilities on the operator and the interest holders. To the extent that such liabilities already exist, under the *Nova Scotia Accord Act* or at common law, the indemnity agreement would be unnecessary. Since the indemnity agreement is not limited to $30 million, nor to damages for spills and debris, it has the potential to expand the absolute liability of industry both with respect to limit as well as the nature of matters giving rise to damages.

As discussed above, the form of exploration licence used by the Board provides for an indemnity by the holders of shares in the licence in favour of the Board and the federal and provincial governments.[44] Assuming that the licence provision is valid and enforceable, a further indemnity from interest holders would be unnecessary. In fact, if the relevant licence contains an indemnity provision, an issue may arise as to whether the indemnity agreement or the licence will prevail if there is an inconsistency. For example, unlike the wording in the exploration licences, the indemnity agreement provides for an exception in cases of negligence or wilful misconduct by the Board.

In any case, the operator will not necessarily be an interest holder (although this is usually the case) and therefore the Board's requirement for an indemnity from the operator goes beyond the indemnity contained in the form of exploration licence. Also, the Guidelines require the operator to provide an indemnity even with respect to work conducted on Crown reserve area, for example a speculative geophysical survey.

Apart from the contractual basis for requiring an indemnity agreement from the interest holders under an exploration licence, the justification for requiring an indemnity as a general matter from an operator would need to be based on s. 142(4)(a) as a requirement "relating to liability for loss, damage, costs or expenses." Assuming that the indemnity agreement is a valid requirement under this provision, the requirement that non-operating interest holders be bound by the indemnity agreement is

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43. *Nova Scotia Accord Act*, *supra* note 1, s. 17 provides that the governments will indemnify Board members and Board employees against costs, including amounts paid to settle an action or satisfy a judgment, reasonably incurred in respect of any civil, criminal or administrative action or proceeding that they may be parties to because of their position. Also, s. 166(9) provides for limited immunity against personal liability in cases where Board staff or other persons take certain actions.

44. Note that the form of indemnity agreement attached to the *Guidelines* does not provide for an indemnity in favour of the federal or provincial governments.

questionable. The financial security requirements in s. 168 of the *Nova Scotia Accord Act* apply to the "applicant for an authorization," which will be the operator. It is also the operator that has absolute liability for spills and debris under s. 167. Section 167 makes other persons liable for spills and debris if they are at fault or negligent, or "are by law responsible for others to whose fault or negligence" the spill or debris is attributable. However, it is suggested that a non-operator will not be liable under the *Nova Scotia Accord Act* merely because it holds an interest in the licence.[45]

It is not clear why the Boards continue to require this indemnity. Under the current form of indemnity agreement, the indemnity does not apply if the Board is negligent. If the Board is added as a defendant in a lawsuit because, for example, it approved the operation that resulted in injury or damage, and it eventually turned out that the Board was not negligent, the indemnity agreement would serve to protect the Board from costs. However, there would appear to be no reason why the interest holders should be responsible for the Board's legal fees in such a case.

*Conclusion*

The requirement of the Boards for immediate, unfettered and direct access to funds up to $30 million results in an increase in costs for oil and gas operators since they need to arrange letters of credit or indemnity bonds. Up to now, the usual method of satisfying the direct access requirement has been through the use of letters of credit. Apart from the cost, the existence of outstanding letters of credit reduces the credit available to an operator for other activities. The direct access requirement is of particular concern for long-term production projects, especially if the Boards require direct access security for abandonment and decommissioning obligations that may not arise for twenty years or more.

The companies currently conducting oil and gas operations offshore Nova Scotia and Newfoundland are all majors with substantial assets; as a practical matter, it is unlikely that it will ever be necessary for the Boards to call the financial security posted by these companies. Industry therefore argues that the Boards should be prepared to accept some form of guarantee or undertaking given directly by the operator in cases where there is sufficient financial capability. However, the other side of that argument is that the cost of a letter of credit or an indemnity bond should

45. The Boards have been willing to allow each participating company in a joint venture to individually post a proportionate share of the financial security instead of requiring the entire amount of security from the operator. This is an accommodation that may be helpful in many cases, but the involvement of interest holders should be at their option.

reflect the financial capability of the operator and should be relatively modest for a substantial company. There may be innovative ways to reduce costs while still providing acceptable security, for example through a cooperative arrangement in which a number of operators post a single security instrument. The Boards have indicated that they would be prepared to consider such an arrangement.[46]

In the meantime, industry has generally accepted the main features of the *Guidelines*, although there are still certain concerns and issues. Some of these are relatively minor and can probably be resolved through continued dialogue with the Boards. The main contentious issues appear to be the requirement for a letter of indemnity and the expansion of obligations to non-operators. If these issues can be resolved, it should be possible for the Boards to issue revised guidelines that will have the broad support of industry.

46. *Guidelines*, *supra* note 32, para. 5.1(c).