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Alan T. Pettie*

Are Royalty Agreements
Required For Canada East Coast
Offshore Oil And Gas?

This article examines the royalty regime in the area offshore the two oil and gas producing provinces on the east coast of Canada. A review of the historical background of the legislative framework is provided. The right to levy royalties on the production of oil and gas is reviewed. The legislative provisions relating to the execution of royalty agreements and the introduction of generic royalty regulations are examined. The article describes specific fiscal and commercial terms which are not included in the current Nova Scotia generic royalty regime and might not be included in the generic regime which might be proposed by Newfoundland. The article concludes that, in all instances, a royalty agreement in some form will be required.

Dans cet article, l'auteur examine le régime de redevances mis en place par les deux provinces de l'Atlantique produisant du pétrole et du gaz extracôtiers. Il rappelle les antécédents historiques du régime législatif actuel. Il se penche sur le droit d'imposer des redevances sur la production pétrolière et gazière. Il examine en outre les dispositions législatives régissant la mise en oeuvre d'ententes relatives aux redevances et la mise en place de règlements généraux régissant les redevances. Il fait le bilan des mesures fiscales et commerciales qui ne sont pas inscrites au règlement actuel en Nouvelle-Écosse et qui risque également d'être exclus d'un projet de règlement analogue à Terre-Neuve. L'auteur conclut que dans tous les cas il faudra instaurer un régime de redevances quelconque.

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I. Introduction and Background

1. Introduction

The first offshore oil production from eastern Canada commenced in 1992 from the Cohasset/Panuke Project off Nova Scotia. Oil production from the Newfoundland offshore commenced in November 1997 from the Hibernia Development Project. The first offshore gas production in Eastern Canada started in December 1999 from the Sable Offshore Energy Project. In each of the Cohasset/Panuke, Hibernia and Sable energy projects, the governments of the respective provinces and each of the participants entered into written royalty agreements. The Terra Nova Development Project participants are also negotiating a written royalty agreement. Generic offshore royalty regulations have been issued for Nova Scotia but not for Newfoundland. This article examines the issue of whether a royalty agreement is required for the development of oil and

gas in the east coast offshore area of Canada, or whether generic offshore regulations will suffice.

2. The Framework

Understanding the royalty regimes in the Canadian east coast offshore requires an understanding of the constitutional and legislative framework in which the regimes were created. The first portion of this article identifies the various components of this framework. Such royalty regimes have been developed, in large part, in response to the constitutional division of powers between the federal and provincial governments. Uncertainty over which level of government has jurisdiction to legislate with regard to oil and gas resources in the offshore has resulted in a "cooperative" regime being developed to manage and administer the exploration and exploitation of offshore oil and gas resources.

The current regime begins with the political accord agreements entered into between each of the Governments of Newfoundland and Labrador and Nova Scotia and the Government of Canada. These political accords, by their words and intentions, ignore the constitutional division of powers between the two levels of government. A joint management structure for the exploration and exploitation of offshore oil and gas resources is set up. These political accords were implemented by the enactment of federal and provincial legislation.

The federal and provincial legislative regime attempts to respect the constitutional division of powers and, in that respect, there are significant differences between the political accords and the governing legislation. The legislative regime operates on the basis of a cooperative technique called "administrative inter-delegation and referential incorporation." From a federal perspective, this means that the Government of Canada has delegated to the province, and to the federal-provincial bodies created under the legislation, the administration of the offshore oil and gas regime. The legislation attempts to adopt, by referential incorporation, various provincial statutes to govern offshore oil and gas exploration and exploitation. For royalty purposes, these statutes include the provincial petroleum acts, each of which allows the provincial government to enter into royalty agreements with the offshore oil and gas project participants. Unfortunately, there are numerous inconsistencies between the manner in which the provincial acts operate and the manner in which the federal and provincial legislative regimes operate.

The royalty regimes in the offshore areas adjacent to Newfoundland and Nova Scotia must be viewed in light of the foregoing. The balance of this article will discuss these issues in greater detail. This will be followed by a review of the specific provisions that need to be dealt with in a royalty

agreement in order to ensure that the oil and gas participants are adequately compensated for their respective interests and investments in the exploration and exploitation of offshore oil and gas resources.

3. *Jurisdiction*

In the decision of the Supreme Court of Canada commonly referred to as the *Hibernia Reference*,¹ the court addressed the issue of jurisdiction and rights over the mineral and other natural resources of the seabed and subsoil of the continental shelf in an area offshore Newfoundland. The Hibernia Development Project is located more than 12 but less than 200 miles off Newfoundland. Both Canada and Newfoundland claimed the rights to the continental shelf. The court held that the continental shelf is neither a part of Newfoundland's nor Canada's territory. The decision is based in part on the 1958 Geneva Convention, which grants the coastal state the right to "exploit" offshore resources. The convention, however, does not grant "sovereignty" over the continental shelf, but the much narrower "sovereign right[s] to explore and exploit" the shelf. The court noted that these "limited" rights "stand in marked contrast to the full sovereignty (saving only other nations' rights of innocent passage) which international law accords to coastal States over their territorial sea." The key passages of the case are as follows:

Continental shelf rights arise as an extension of the coastal State's sovereignty, but it is an extension in the form of something less than full sovereignty. The [International Court of Justice in the *North Sea Continental Shelf* cases, I.C.J. Reports, 1969, p. 3] referred to the "title" in the continental shelf (p. 31) and said the shelf may be "deemed" to be part of the coastal State's territory in a certain sense (p. 31). *But in the ordinary meaning of the term, the continental shelf is not part of a coastal State's territory. The coastal State cannot "own" the continental shelf as it can "own" its land territory. The regulation by international law of the uses to which the continental shelf may be put is simply too extensive to consider the shelf to be part of the State's territory. International law concedes dominion to the State in its land territory, subject to certain definite restrictions. By contrast, in the continental shelf the limited rights that international law accords are the sum total of the State's rights.*

At international law, then, the continental shelf off Newfoundland is outside the territory of the nation state of Canada. Since, as a matter of municipal law, neither Canada nor Newfoundland purports to claim anything more than international law recognizes, we are here concerned with an area outside the boundaries of either Newfoundland or Canada. In other words, we are concerned with extraterritorial rights.

1. *Reference by the Governor-in-Council Concerning Property in and Legislative Jurisdiction Over the Seabed and Subsoil of the Continental Shelf Offshore Newfoundland*, [1984] 1 S.C.R. 86 [hereinafter *Hibernia Reference*].

Much of the argument in the present case is based on the assumption that continental shelf rights are proprietary. We do not think continental shelf rights are proprietary in the ordinary sense. In the words of the 1958 Geneva Convention, they are "sovereign rights" and they appertain to the coastal State as an extension of rights beyond where its ordinary sovereignty is exercised. In pith and substance they are an extraterritorial manifestation of, and an incident of, the external sovereignty of a coastal State.²

4. *Accord*

a. *Newfoundland*

Subsequent to the *Hibernia Reference*, the Governments of Canada and Newfoundland and Labrador entered into the Newfoundland Accord.³ The relevant portions of the Newfoundland Accord suggest that the Government of Canada intended to cede most of its authority (although not ownership) over the offshore to the Canada-Newfoundland Offshore Petroleum Board (CNOBP) and to the Government of Newfoundland and Labrador. The following provisions of the Newfoundland Accord support this view:

DECISIONS IN RELATION TO OFFSHORE MANAGEMENT

21. For the purposes of defining the role of the Board and Ministers, decisions on offshore resources shall be divided as follows:

- (a) decisions made by Parliament, the Government of Canada, or Federal Ministers (clause 22);
- (b) decisions made by the Newfoundland Legislature, the Newfoundland Government or Provincial Ministers (clause 23);
- (c) decisions made by the Board subject to no ministerial review or directives (clause 24); and
- (d) decisions made by the Board subject to the approval of the appropriate Minister (Fundamental Decisions, clause 25), or subject to directions from the Ministers of both governments (clause 33a).

23. Decisions made by the Newfoundland Legislature, the Newfoundland Government, or Provincial Ministers alone comprise:

- (a) the royalty regime and other provincial-type revenues (see clause 37); and
- (b) decisions related to provincial laws of general application having effect in the offshore pursuant to clause 61.

2. *Ibid.* at 96-97 [emphasis added].

3. The Atlantic Accord Memorandum of Agreement between the Government of Canada and the Government of Newfoundland and Labrador on offshore oil and gas resource management and revenue sharing (11 February 1985) [hereinafter Newfoundland Accord].

REVENUE SHARING

36. The principles of revenue sharing between Canada and Newfoundland with respect to revenues from petroleum-related activities in the offshore area shall be the same as those which exist between the Government of Canada and other hydrocarbon producing provinces with respect to revenues from petroleum-related activities on land. The federal legislation implementing the Accord, therefore, will permit the Government of Newfoundland and Labrador to establish and collect resource revenues and provincial taxes of general application as if these petroleum-related activities were on land within the province, through incorporation by reference of Newfoundland laws (as amended from time to time), or through other appropriate legislative mechanisms.

37. On the basis of the foregoing, Newfoundland shall receive the proceeds of the following revenues from petroleum related activity in the offshore area:

- (a) royalties;
- (b) a corporate income tax which is the same as the generally prevailing provincial corporate income tax in the province;
- (c) a sales tax that is the same as the generally prevailing provincial sales tax in the province;
- (d) any bonus payments;
- (e) rentals and licence fees; and
- (f) other forms of resource revenue and provincial taxes of general application, consistent with the spirit of this Accord, as may be established from time to time.

38. The Board shall collect royalties, bonus payments, rentals and licence fees. These revenues and other offshore revenues referred to in clause 37 shall be remitted to the Government of Newfoundland and Labrador.

b. *Nova Scotia*

Subsequent to the Newfoundland Accord, the Governments of Canada and Nova Scotia entered into the Canada-Nova Scotia Offshore Petroleum Resources Accord.⁴ The relevant portions of the Nova Scotia Accord suggest that Canada intended to cede most of its authority (although not ownership) over the offshore to the Canada-Nova Scotia Offshore Petroleum Board (CNSOPB) and to the Government of Nova Scotia. The following provisions of the Nova Scotia Accord support this view:

4. Memorandum of agreement entitled "Canada-Nova Scotia Offshore Petroleum Resources Accord" between the Government of Canada and the Government of Nova Scotia dated August 26, 1986 [hereinafter *Nova Scotia Accord*].

PART II - Division of Powers

9.01 For the purpose of defining the role of the Board and Ministers, decisions in the Offshore Area shall be divided as follows:

- (a) decisions made by Parliament, the Government of Canada, or Federal Ministers (Article 10);
- (b) decisions made by the Nova Scotia Legislature, the Nova Scotia Government or Provincial Ministers (Article 11);
- (c) decisions made by the Board not subject to ministerial review (Article 12); and
- (d) fundamental decisions made by the Board subject to ministerial review (Article 13).

Article 11 Provincial Powers

11.01 Decisions made by the Nova Scotia Legislature, the Government of Nova Scotia or Provincial Ministers comprise those

- (a) related to the royalty regime and other provincial-type financial instruments; and
- (b) made pursuant to provincial law of general application.

Article 26 - Fiscal Instruments

26.01 Responsibility for, control of and revenues from fiscal instruments shall be allocated as if the Petroleum Resources and the activities related to the Petroleum Resources were located on the land portion of the Province of Nova Scotia.

26.02 The Province of Nova Scotia shall receive the proceeds of royalties and other provincial-type taxes of general application from petroleum-related activity in the Offshore Area. Without limiting the generality of the foregoing, these include:

- (a) royalties;
- (b) bonus payments;
- (c) rental and licence fees;
- (d) provincial corporate income tax;
- (e) sales tax.

...

26.05 All revenues collected or assessed pursuant to this Article shall be deposited directly into a specified purpose account, to be known as the Nova Scotia Offshore Revenue Account and shall be paid by the Government of Canada to the Province of Nova Scotia consistent with payment schedules under the Canada-Nova Scotia Tax Collection Agreement.

5. *Accord Acts*

a. *Newfoundland*

Canada and Newfoundland enacted almost reciprocal pieces of legislation in 1988. Canada enacted the *Canada-Newfoundland Atlantic Accord Implementation Act*.⁵ Newfoundland enacted the *Canada-Newfoundland Atlantic Accord Implementation Newfoundland Act*.⁶

Division VI, consisting of ss. 97 through 100 of the *Newfoundland Accord Act*, provides for the reservation to Her Majesty in right of Canada of royalties, interest and penalties in respect of petroleum.⁷ Subsection 97(2) provides:

There is hereby reserved to Her Majesty in right of Canada and each holder of a share in a production licence is liable for and shall *pay to Her Majesty in right of Canada*, in accordance with subsection (4), the royalties, interest and penalties that would be payable in respect of petroleum under the *Petroleum and Natural Gas Act* if the petroleum were produced from areas within the Province.⁸

The holder of a share in a production licence is not subject to a federal royalty on petroleum where that petroleum is the subject of a provincial royalty under the *Petroleum and Natural Gas Act*.⁹ Subsection 97(3) reads:

Notwithstanding subsection (2), where petroleum is subject to a royalty under the *Petroleum and Natural Gas Act*, that petroleum is not subject to a royalty under subsection (2).

The *Petroleum and Natural Gas Act* and regulations thereunder apply for the purposes of s. 97 (subject to certain modifications as the circumstances require, including changing references to “Her Majesty in right of the Province” to “Her Majesty in right of Canada”, and changing references to the “Province of Newfoundland” to the “offshore area”).¹⁰ Subsection 97(4) is the critical provision with regard to referential incorporation. Subsection 97(4) reads:

Subject to this Act and the regulations, the *Petroleum and Natural Gas Act* and any regulations made thereunder apply, with such modifications as the circumstances require, for the purposes of this section and, without limiting the generality of the foregoing,

5. *Canada-Newfoundland Atlantic Accord Implementation Act*, S.C. 1987, c. 3 [hereinafter *Newfoundland Accord Act*].

6. *Canada-Newfoundland Atlantic Accord Implementation Newfoundland Act*, R.S.N. 1990, c. C-2 [hereinafter *Newfoundland Accord Act* (Newfoundland)].

7. *Supra* note 5.

8. *Ibid.*, s. 97(3) [emphasis added].

9. R.S.N. 1990, c. P-10.

10. *Supra* note 5, s. 97(4).

- (a) a reference in that Act to *Her Majesty in right of the Province* shall be deemed to be a reference to *Her Majesty in right of Canada*; and
- (b) a reference in that Act to the *Province of Newfoundland* or the *province* shall be deemed to be a reference to the *offshore area*. [emphasis added]

The current *Petroleum and Natural Gas Act* does not use the phrase “Her Majesty in right of the Province”, instead choosing to use the phrase “the Crown in the right of the province”. This phrase was used in the predecessor *Petroleum and Natural Gas Act*.¹¹ Probably nothing turns on it, but it does provide the first of many inconsistencies when considering the concepts of referential incorporation and delegation.

Offshore area is defined to mean “those submarine areas lying seaward of the low water mark of the Province and extending, at any location, as far as (a) any prescribed line, or (b) where no line is prescribed at that location, the outer edge of the continental margin or a distance of two hundred nautical miles from the baselines from which the breadth of the territorial sea of Canada is measured, whichever is the greater.”¹² No regulations have been passed prescribing lines and there have been no charts issued under ss. 5(1) and (2) of the *Newfoundland Accord Act*, which creates some uncertainty as to the area encompassed in the offshore area.

Her Majesty in right of Canada is not reserved a Crown share in any interest issued with respect to the offshore area pursuant to the *Petroleum and Natural Gas Act* or any regulation thereunder. Subsection 97(5) reads:

No provision of the *Petroleum and Natural Gas Act* or any regulation made thereunder shall apply so as to reserve to Her Majesty a Crown share in any interest issued in respect of any portion of the offshore area.¹³

The *Newfoundland Accord Act* (Newfoundland) provides in s. 8(1) that it applies to the offshore area. The Government of Newfoundland and Labrador is legislating directly on matters upon which it may not have legislative authority.

11. R.S.N. 1970 c. 294.

12. *Supra* note 5, s. 2.

13. *Ibid.*, s. 97(5) [emphasis added].

b. Nova Scotia

Canada and Nova Scotia also enacted reciprocal legislation which is similar but not identical to the *Newfoundland Accord Act* and *Newfoundland Accord Act* (Newfoundland). The *Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act*¹⁴ was enacted by the Government of Canada. Nova Scotia enacted the *Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation (Nova Scotia) Act*.¹⁵

Division VI of the *Nova Scotia Accord Act*, consisting of ss. 99 through 102, reads almost identically to the provisions in Division VI of the *Newfoundland Accord Act*. However, there are some important differences between the two pieces of legislation. There is reserved to Her Majesty in right of Canada royalties, interest and penalties in respect of petroleum. Subsection 99(1) reads:

There is hereby reserved to Her Majesty in right of Canada, and each holder of a share in a production licence is liable for and shall pay to Her Majesty in right of Canada, in accordance with subsection (3), the royalties, interest and penalties that would be payable in respect of petroleum under the *Offshore Petroleum Royalty Act* if the petroleum were produced from Nova Scotia lands within the meaning of the *Provincial Act*.¹⁶

The holder of a share in the production licence is not subject to a federal royalty¹⁷ where that petroleum is the subject of a provincial royalty under the *Offshore Petroleum Royalty Act*.¹⁸ Subsection 99(2) of the *Nova Scotia Accord Act* reads:

Notwithstanding subsection (1), where petroleum is subject to a royalty under the *Offshore Petroleum Act*, that petroleum is not subject to a royalty under subsection (1).

The *Offshore Petroleum Royalty Act* and regulations thereunder apply for the purposes of s. 99, subject to such modifications as the circumstances require, including changing references to “Her Majesty in right of the Province” to “Her Majesty in right of Canada”, changing references to the “Province of Nova Scotia” or the “Province of Nova Scotia lands” to “offshore area” and by changing references from the “Minister responsible

14. *Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act*, S.C. 1988, c. 28 [hereinafter *Nova Scotia Accord Act*].

15. *Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation (Nova Scotia) Act*, S.N.S. 1987, c. 3, [hereinafter *Nova Scotia Accord Act (Nova Scotia)*].

16. *Supra* note 14, s. 99(1) [emphasis added].

17. *Ibid.*, s. 99(2)

18. S.N.S. 1987, c. 9.

for the administration of that Act” to the “Federal Minister” (*i.e.* the Minister of Natural Resources).¹⁹ Subsection 99(3) is the critical provision with regard to referential incorporation. It reads:

Subject to this Act and the regulations, the Offshore Petroleum Royalty Act and any regulations made thereunder apply, with such modifications as the circumstances require, for the purposes of this section and, without limiting the generality of the foregoing,

- (a) a reference in that Act to *Her Majesty in right of the Province* shall be deemed to be a reference to *Her Majesty in right of Canada*;
- (b) a reference in that Act to the *Province of Nova Scotia* or the *Province of Nova Scotia lands* shall be deemed to be a reference to the *offshore area*; and
- (c) a reference in that Act to the *Minister* responsible for the administration of that Act shall be deemed to be a reference to the *Federal Minister*. [emphasis added]

Her Majesty in right of Canada is not reserved a Crown share in any interest issued in respect of any portion of the offshore area pursuant to the *Nova Scotia Accord Act* or the *Offshore Petroleum Royalty Act* or regulations made thereunder. Subsection 99(7) reads:

No provision of *this Act or the Provincial Act or any regulation made thereunder* shall apply so as to reserve to Her Majesty a Crown share in any interest issued in respect of any portion of the offshore area.²⁰

Subsections 97(2), (4) and (5) of the *Newfoundland Accord Act* are significantly different from ss. 99(1), (3) and (7) of the *Nova Scotia Accord Act*. In the *Newfoundland Accord Act*, the reference is to petroleum “produced from areas within the Province” and it is provided that no provision of the *Petroleum and Natural Gas Act* reserves to Her Majesty in right of Canada a Crown share. In the *Nova Scotia Accord Act*, the reference is to petroleum “produced from Nova Scotia lands within the meaning of the Provincial Act”²¹ and it is provided that no provision of the *Nova Scotia Accord Act* or *Nova Scotia Accord Act* (Nova Scotia) reserves to Her Majesty in right of Canada a Crown share. These significant differences have enabled Nova Scotia to maintain the position that the *Hibernia Reference* does not apply in respect to oil and gas rights offshore Nova Scotia, that the Government of Nova Scotia is in a better

19. *Supra* note 14, s. 99(3). The changing of the cross-references from the provincial minister to the federal minister are important when considering the consequences of s. 22(b) of the *Offshore Petroleum Royalty Act*.

20. *Nova Scotia Accord Act, ibid.*, s. 99(7) [emphasis added].

21. For further discussion of Nova Scotia’s position on Nova Scotia lands, see Section III.2 of this article.

position than that of Newfoundland regarding the rights to oil and gas in the offshore and that Nova Scotia has the exclusive right to enter into royalty agreements in respect to the production of oil and gas in the offshore area.

The *Nova Scotia Accord Act* (Nova Scotia) provides in s. 8(1) that it applies to Nova Scotia lands within the offshore area. The language in s. 8(1) would appear to better satisfy the case law regarding referential incorporation and inter-delegation discussed in Part IV of this article than the language used in s. 8(1) of the *Newfoundland Accord Act* (Newfoundland).

II. Royalty Acts

1. *Petroleum and Natural Gas Act*

As noted earlier, the *Newfoundland Accord Act* incorporates the Newfoundland royalty regime by reference. Part II of the *Petroleum and Natural Gas Act*, consisting of ss. 30 through 43, as incorporated by reference pursuant to s. 97(4) of the *Newfoundland Accord Act*, contains the principal legislative provisions regarding the royalties on petroleum produced in the area off Newfoundland. A royalty determined under Part II is reserved to the Crown in right of Newfoundland on “all petroleum recovered under the *Petroleum and Natural Gas Act*.”²² A basic royalty²³ and an incremental royalty²⁴ is payable by each holder of a share of a lease to the Crown in right of Newfoundland as prescribed by the regulations.

Lease is defined to include a similar instrument issued under the *Newfoundland Accord Act* and the *Newfoundland Accord Act* (Newfoundland). No leases are actually issued under those acts. Rather, exploration licences, significant discovery licences and production licences may be issued thereunder by the CNOPB.²⁵ Production licences are probably similar to leases. However, exploration licences and significant discovery licences do not confer “the exclusive right to produce petroleum from those portions of the offshore area” or “title to the petroleum so

22. *Supra* note 9, s. 31 [emphasis added].

23. *Ibid.*, s. 32. Section 32 reads: “Petroleum produced according to a lease under this Act is subject to, and each holder of a share in the lease is liable for and shall pay to the Crown in right of the province, a basic royalty in an amount and in a manner prescribed by the regulations” [emphasis added].

24. *Ibid.*, s. 33. Section 33 reads: “Each holder of a share of a lease is liable for and shall pay to the Crown in right of the province an incremental royalty that may be prescribed by the regulations.”

25. The CNOPB issues an exploration licence, significant discovery licence or production licence pursuant to s. 57 and Division II of the *Newfoundland Accord Act* and s. 56 and Division II of the *Newfoundland Accord Act* (Newfoundland).

produced”, which rights are conferred by production licences.²⁶ Accordingly, exploration licences and significant discovery licences are probably not similar to “leases.” The authority for the Lieutenant Governor in Council²⁷ to enter into a royalty agreement with the holder(s) of a lease may be limited to holders(s) of production licences. This raises the same uncertainty with respect to the timing of the execution of Newfoundland offshore royalty agreements as exists regarding Nova Scotia offshore royalty agreements.²⁸ The Hibernia Development Project Royalty Agreement²⁹ was executed September 1, 1990, which was after the issuance of the production licence on March 21, 1990.

2. *Offshore Petroleum Royalty Act*

The *Nova Scotia Accord Act* also incorporates the Nova Scotia royalty regime by reference. The *Offshore Petroleum Royalty Act*, as incorporated by reference pursuant to s. 99(3) of the *Nova Scotia Accord Act*, provides for royalties on petroleum in the area offshore Nova Scotia. Her Majesty in right of Nova Scotia reserves such royalties as may be prescribed in respect of petroleum produced from Nova Scotia lands in the offshore area.³⁰ The minister may require all or any part of a royalty be paid in money or in kind, in accordance with the regulations.³¹ “Offshore area”³² has the same definition as in the *Nova Scotia Accord Act* (Nova Scotia).

In the *Nova Scotia Accord Act* (Nova Scotia), “offshore area” is defined to mean the “lands and submarine areas within the limits described in Schedule I.”³³ “Nova Scotia lands” is defined to mean “(i) Sable Island, and (ii) those submarine areas that belong to Her Majesty in right of the Province or in respect of which Her Majesty in right of the Province has the right to dispose of or exploit the natural resources, and that are within the offshore area.”³⁴ Sable Island is defined as “the area, whether above or under water, in the offshore area, that is within the limits described in Schedule III.”³⁵ However, the *Nova Scotia Accord Act*

26. *Supra* note 5, ss. 80(1) (c) and (d) and *supra* note 6, ss. 79(1)(c) and (d).

27. *Supra* note 9, s. 34.

28. *Supra* note 18.

29. *Infra* note 126.

30. *Supra* note 18, s. 3(1). It provides: “There is hereby reserved to Her Majesty in right of the Province, and each holder of a share in a production licence is liable for and shall pay, in accordance with the regulations, such royalties as may be prescribed, at the rates prescribed, in respect of petroleum produced from the Nova Scotia lands in the offshore area and in respect of the periods prescribed.”

31. *Ibid.*, s. 3(2).

32. *Ibid.*, s. 2(1)(c).

33. *Supra* note 15, s. 2(r).

34. *Ibid.*, s. 2(p).

35. *Ibid.*, s. 2(w).

provides that the Governor-in-Council may make regulations amending the description of the limits set out in Schedule I for the purposes of the definition “offshore area.”³⁶ The federal minister may also cause charts to be issued setting out the offshore area.³⁷ No regulations have been issued amending the description of the limits for the purposes of the definition of offshore area and no charts have been issued.

3. *Relationship With the Accord Acts*

As previously indicated in this article, the provincial royalty regimes do not work in perfect unison with the federal *Accord Acts*. Three examples of the gaps are noted below.

a. *Offshore Area*

It is noted that the *Petroleum and Natural Gas Act* provides for royalties on lands within the province and then relies on s. 97(4) of the *Newfoundland Accord Act* to referentially incorporate the *Petroleum and Natural Gas Act* with regard to the offshore area. The *Offshore Petroleum Royalty Act* also provides for royalties on Nova Scotia lands in the offshore area and then relies on s. 99(3) of the *Nova Scotia Accord Act* to referentially incorporate the *Offshore Petroleum Royalty Act* with regard to that area off Nova Scotia which is not Nova Scotia lands.

In the *Newfoundland Accord Act* (Newfoundland) the offshore area is the submarine areas lying seaward of the low water mark and royalties are payable by reference to petroleum “produced from areas within the Province.”³⁸ The language in the *Nova Scotia Accord Act* (Nova Scotia) regarding the offshore area references submarine areas and royalties are payable by reference to the offshore area in which the province has the right to dispose of or exploit the natural resources.³⁹ The definition of “Nova Scotia lands” directly states that Sable Island and other areas offshore Nova Scotia are within the sole jurisdiction of the Government of Nova Scotia. The Government of Nova Scotia maintains the position that it alone has authority over the natural resources in the offshore and that the *Hibernia Reference* is distinguishable as regards the laws of Nova Scotia.

36. *Supra* note 14, s. 5(1).

37. *Ibid.*, s. 5(2).

38. *Supra* note 5, s. 97(2).

39. *Supra* note 14, s. 99(1).

b. Lease

In the *Newfoundland Accord Act* (Newfoundland) and the *Petroleum and Natural Gas Act*, a basic royalty is paid on “petroleum produced according to a lease under” the *Petroleum and Natural Gas Act*.⁴⁰ Although the language is less than clear with regard to the basic royalty, the language is much clearer with regard to the incremental royalty. With respect to the incremental royalty, a royalty is payable by the holder of a share of a lease.⁴¹ Section 30 of the *Petroleum and Natural Gas Act* provides that “lease” includes similar instruments issued under the *Newfoundland Accord Act* and the *Newfoundland Accord Act* (Newfoundland).⁴² Very few leases have been issued under the *Petroleum and Natural Gas Act*.⁴³ Exploration licences, significant discovery licences and production licences have been issued under the authority of the *Newfoundland Accord Act* and *Newfoundland Accord Act* (Newfoundland). The use of the phrase “according to a lease under this Act” causes uncertainty as to whether “leases” issued by the CNOPB pursuant to the *Newfoundland Accord Act* or the *Newfoundland Accord Act* (Newfoundland) can be the subject of a basic royalty under the *Petroleum and Natural Gas Act*.

c. Sable Island

There is confusion as to the right to dispose of or exploit natural resources under Sable Island. Subsection 8(1) of the *Nova Scotia Accord Act* provides that it applies within the offshore area, which means the lands and submarine areas within the limits described in Schedule I. Sable Island is not excluded from the offshore area. Pursuant to s. 8(2) of the *Nova Scotia Accord Act*, the *Canada Petroleum Resources Act*⁴⁴ does not apply within the offshore area.

Frontier lands⁴⁵ are defined to have the same meaning as in the *Canada Petroleum Resources Act*. In the *Canada Petroleum Resources Act*, frontier lands mean

40. *Supra* note 9, s. 32 [emphasis added].

41. *Ibid.*, s. 33.

42. *Ibid.*

43. Production Licence 1001 in regards to the Hibernia Project was issued by the CNOPB. Significant Discovery Licences 196, 208, 1032, 1033 and 1034 relating to the Terra Nova Project were also issued by the CNOPB.

44. R.S.C. 1985 (2d Supp.), c. 36.

45. *Supra* note 15, s. 2(k).

lands that belong to Her Majesty in right of Canada, or in respect of which Her Majesty in right of Canada has the right to dispose of or exploit the natural resources, and that are situated in (a) the Yukon Territory, the Northwest Territories or Sable Island, or (b) those submarine areas, not within a province, adjacent to the coast of Canada and extending throughout the natural prolongation of the land territory of Canada to the outer edge of the continental margin or to a distance of two hundred nautical miles from the baselines from which the breadth of the territorial sea of Canada is measured, whichever is the greater. . . ⁴⁶

Portions of the Thébaud, West Venture and South Venture fields are within the limits described in Schedule III to the *Nova Scotia Accord Act* as being Sable Island. The Government of Nova Scotia would argue such portions of such fields are entirely within the jurisdiction of the Government of Nova Scotia. However, pursuant to the *Canada Petroleum Resources Act*, the Government of Canada has reserved a net profits royalty with respect to petroleum produced from frontier lands.⁴⁷ If Sable Island is not meant to be subject to the *Canada Petroleum Resources Act*, then why is it expressly included in the definition of “frontier lands”?

III. Royalty Collection and Administration Agreement

In order to close some of the legislative, constitutional, regulatory and administrative gaps between the *Newfoundland Accord Act* and the *Nova Scotia Accord Act* (collectively the *Accord Acts*) and the *Newfoundland Accord Act* (Newfoundland) and the *Nova Scotia Accord Act* (Nova Scotia) (collectively the *Provincial Accord Acts*), the legislation contemplated a collection and administration agreement between the government of the province, the Government of Canada and the CNOPB or CNSOPB, as applicable.

46. *Supra* note 44, s. 2.

47. *Ibid.*, s. 55(1). Subsection 55(1) reads as follows: “There are hereby reserved to Her Majesty in right of Canada, and each holder of a share in a production licence is liable for and shall pay, in accordance with the regulations, such royalties as may be prescribed, at the rates prescribed, in respect of petroleum produced from frontier lands and in respect of the periods prescribed.” Pursuant thereto, the *Frontier Lands Petroleum Regulations* S.O.R./92-26 have been issued prescribing royalties in respect to petroleum produced from Sable Island and the other frontier lands.

1. Newfoundland

a. No Agreement

The *Newfoundland Accord Act*⁴⁸ and the *Newfoundland Accord Act (Newfoundland)*⁴⁹ establish a seven-member CNOPB for the joint operation of the two statutes. Sections 98 through 100 of the *Newfoundland Accord Act* are substantially the same as the provisions in ss. 100 through 102 of the *Nova Scotia Accord Act*. However, these Newfoundland provisions are largely inactive, as no royalty collection or administration agreement has been entered into as of August 15, 2000 between the CNOPB, the Government of Canada and the Government of Newfoundland and Labrador. The *Newfoundland Accord Act (Newfoundland)* does not have the corresponding provision found in the *Nova Scotia Accord Act (Nova Scotia)*⁵⁰ which provides therein that payments to the CNSOPB are a good and sufficient discharge of liability to make payments.

b. One Cent per Barrel Statutory Royalty

Without a royalty collection and administration agreement, the participants in the Hibernia Development Project were presented with a constitutional quagmire. Rather than involve the Government of Canada in the execution of the Hibernia Development Project Royalty Agreement,⁵¹ Newfoundland enacted the *Oil Royalty Regulations*⁵² under the authority of s. 39 of the *Petroleum and Natural Gas Act*. The *Oil Royalty Regulations* provide for the following statutory royalty:

Liability for basic royalties

3(1) Each holder of a share in a *lease issued under the Act before April 1, 1990* shall be liable for and shall pay to the Crown a basic royalty in the amount of 1¢ for each barrel of petroleum produced under the lease to which that holder of a share in the lease is entitled.

(2) The basic royalty shall be paid at the time and in the manner that may be prescribed by the minister.

Exemption

4. A holder of a share of a *lease issued under the Act before April 1, 1990* shall not pay to the Crown an incremental royalty in respect of petroleum produced under that lease. [emphasis added]

48. *Supra* note 5, s. 9.

49. *Supra* note 6, s. 9.

50. *Supra* note 14, s. 46.

51. *Infra* note 126.

52. *Oil Royalty Regulations*, Nfld. Reg. 22/96.

The fix, however, was intended only for the Hibernia Development Project. Production Licence 1001 dated March 21, 1990 appears to have been issued by the CNOBP prior to April 1, 1990. "Lease" is not defined in the *Oil Royalty Regulations*. However, in the *Petroleum Regulations*, a "lease" is an instrument which includes the "exclusive right to produce petroleum" from "lands and submerged areas within the province that lie landward of the ordinary low water mark along the open coast of the province."⁵³ A lease is therefore similar to a production licence but not similar to a significant discovery licence or an exploration licence issued under the *Newfoundland Accord Act* and the *Newfoundland Accord Act* (Newfoundland). However, it is noted that a production licence is not "issued under the Act"; rather it is issued under the *Newfoundland Accord Act* and the *Newfoundland Accord Act* (Newfoundland). The date limitation means that other projects will require a similar or alternative fix. Accordingly, the Government of Canada pursuant to the *Oil Royalty Regulations* and s. 97(2) of the *Newfoundland Accord Act* would receive a nominal 1 cent per barrel basic royalty on petroleum produced from the Hibernia Development Project. Pursuant to the *Newfoundland Accord Act*, such royalties were payable and required to be remitted to the Receiver General. As that petroleum is subject to a royalty under the *Petroleum and Natural Gas Act*,⁵⁴ it would not be subject to a further royalty under the *Newfoundland Accord Act*.⁵⁵

The Government of Canada does not appear to have any desire in being involved in royalty negotiations. Furthermore, Newfoundland seems to have even less desire in involving Canada in royalty discussions.

The current solution for the Terra Nova Development Project is to pass further oil royalty regulations or to amend the *Oil Royalty Regulations* to change the April 1, 1990 date reference. The current "solution" would not work for a generic offshore royalty regime. Another alternative should be developed.

2. Nova Scotia

a. Administration of Royalty

Subsection 100(1) of the *Nova Scotia Accord Act* provides that the federal minister may enter into an agreement delegating certain powers with respect to the collection and administration of royalties, interest and penalties payable under s. 99.⁵⁶ The federal minister, with the approval

53. *Petroleum Regulations*, Nfld. Reg. 1151/96, ss. 6. and 39(1)(d).

54. *Supra* note 9, s. 32.

55. *Supra* note 5, s. 97(3).

56. *Supra* note 14, ss. 100-102.

of the Governor in Council, shall enter into an agreement with Nova Scotia and the CNSOPB

with respect to the *collection and administration, on behalf of the Government of Canada*, of the royalties, interest and penalties payable under section 99 and, without limiting the generality of the foregoing, with respect to the granting of refunds or the making of other payments in respect of those royalties, interest and penalties in accordance with the terms and conditions set out in the agreement.⁵⁷

The *Nova Scotia Accord Act* also provides that:

(6) An administration agreement may provide that, where any payment is received by the Government of the Province on account of any royalties, interest, penalties or other sum payable by a person under section 99, or under both section 99 and the Offshore Petroleum Royalty Act, the payment so received may be applied by the Government of the Province towards the royalties, interest, penalties or other sums payable by the person under any such provision or Act in such manner as is specified in the agreement, notwithstanding that the person directed that the payment be applied in any other manner or made no direction as to its application.

(7) Any payment or part thereof applied by the Government of the Province in accordance with an administration agreement towards the royalties, interest, penalties or other sums payable by a person under section 99

(a) relieves that person of liability to pay such royalties, interest, penalties or other sums to the extent of the payment or part thereof so applied; and

(b) shall be deemed to have been applied in accordance with a direction made by that person.⁵⁸

The *Offshore Petroleum Royalty Act* provides that

The Minister may . . .

enter into an agreement with the Board and the federal Government for the collection and administration of *royalties* with the ability to delegate *any ministerial power, duty or function* pursuant to this Act.⁵⁹

Pursuant to s. 100(2) of the *Nova Scotia Accord Act*, s. 22(c) of the *Offshore Petroleum Royalty Act* and the Royalty Collection and Administration Agreement,⁶⁰ the CNSOPB, the Government of Canada

57. *Ibid.*, s. 100(3) [emphasis added].

58. *Ibid.*, ss. 100(6) and (7).

59. *Supra* note 18, s. 22(c) [emphasis added].

60. . Undated agreement entitled "Royalty Collection and Administration Agreement" between Her Majesty the Queen in right of Canada as represented by the Minister of Energy, Mines and Resources and Her Majesty the Queen in right of the Province of Nova Scotia as represented by the Minister of Natural Resources and the CNSOPB (approved by Order in Council No. P.C. 1992-4/957 on May 7, 1992 on behalf of the Government of Canada and by Order in Council No. 92-619 on June 16, 1992 on behalf of the Province) [hereinafter Royalty Collection and Administration Agreement].

and the Government of Nova Scotia agreed to the terms and conditions upon which the collection and administrations of royalties were to occur.

Section 3.01 and ss. 3.02(a), (b) and (c) of the Royalty Collection and Administration Agreement are a delegation by the federal Minister of Energy, Mines and Resources, on behalf of Canada, of its authority under ss. 22(a) and (b) of the *Offshore Petroleum Royalty Act*. The relevant portions of the Royalty Collection and Administration Agreement provide:

3.01 The Provincial Minister, on behalf of and as agent for the Federal Minister, is hereby authorized to perform all the duties and functions and to exercise all the powers that the Federal Minister has under Section 99 and subsection 100(1) of the Federal Accord Act for the purposes of these Sections.

3.02 Without limiting the generality of Article 3.01, the Provincial Minister shall perform all duties in respect of and related to the administration of Royalties, including

- (a) assessment of Royalties;
- (b) pursuant to Section 22(a) of the Royalty Act, the entering into of agreements with the holders of production licences respecting administrative and operational matters;
- (c) pursuant to Section 22(b) of the Royalty Act, with the approval of the Governor in Council, the entering into of agreements with the holders of production licences or shares therein respecting any matter that is within the regulation making power of the Governor in Council;...

3.03 The Provincial Minister shall require and direct the holders of production licences, or shares therein, to make payment in respect of Royalties to the Board to the credit of the Receiver General of Canada at a time and in a manner determined by the Provincial Minister.

6.01 Canada, the Province or the Board may terminate this Agreement on giving six (6) months prior notice to the other Parties. Notice shall be given in writing and shall be executed by the Federal Minister, the Provincial Minister or the Chairman of the Board.

8.01 The provisions of this Agreement shall not be construed as providing a basis for any claim by or on behalf of Canada or the Province in respect of any entitlement to or legislative jurisdiction over any offshore area or any living or non-living resources of any offshore area.

The analysis of the authority to delegate is dealt with in the next part.⁶¹ The Royalty Collection and Administration Agreement was entered into by the Province of Nova Scotia as represented by the Minister of Natural Resources. Subsection 22(c) of the *Offshore Petroleum Royalty Act* only permits an agreement to be entered into for the administration of “royalties.” However, the only royalties referenced in the *Offshore Petroleum Royalty*

61. Refer to Part IV entitled “Administrative Inter-delegation and Referential Incorporation”

Act are the royalties on Nova Scotia lands in the offshore area. If the foregoing provisions are not effective, the federal delegation of authority would be dependent upon a general power to contract.

b. *Collection of Royalty*

The *Nova Scotia Accord Act*⁶² and the *Nova Scotia Accord Act* (Nova Scotia)⁶³ provide for the joint establishment of the five-member CNSOPB. The *Nova Scotia Accord Act* (Nova Scotia) is unique in that it provides that

46 (1) A payment of royalty, rental, licence fee, cash bonus or deposit required to be made pursuant to the *Offshore Petroleum Royalty Act* or Parts II and III of this Act in respect of the offshore area shall be made to the Board.

(2) A payment made to the Board pursuant to

(a) the federal Implementation Act in respect of those kinds of payments referred to in subsection (1); or

(b) this Section,

is a good and sufficient discharge of liability to make payment of such amounts pursuant to the *Offshore Petroleum Royalty Act* or Parts II and III of this Act.⁶⁴

Although somewhat confusing, it would appear that the *Nova Scotia Accord Act* would require the payment of royalties, interest and penalties payable under s. 99 of that statute be made payable and remitted to the Receiver General.⁶⁵ The *Nova Scotia Accord Act* further provides that, upon collection or receipt of royalties, interest and penalties by the CNSOPB, the royalties are deposited to the credit of the Receiver General and paid into the Consolidated Revenue Fund.⁶⁶ This would suggest that royalties are paid to the account of the Government of Canada. The *Nova Scotia Accord Act* (Nova Scotia) provides that all revenues collected or assessed by the CNSOPB or Nova Scotia in respect of royalties, bonuses, rentals, licence fees and corporate or retail sales tax shall be deposited by the CNSOPB and Nova Scotia into the Nova Scotia Offshore Revenue Account and paid by Canada to Nova Scotia consistent with payment schedules under the Canada-Nova Scotia Tax Collection Agreement.⁶⁷ This provision would apply to a royalty payment regarding Nova Scotia

62. *Supra* note 14, s. 9.

63. *Supra* note 15, s. 9.

64. *Ibid.*, s. 46.

65. *Supra* note 14, s. 101(1).

66. *Ibid.*, s. 101(2).

67. *Supra* note 15, s. 47.

lands in the offshore. If the offshore lands were not Nova Scotia lands, then the *Nova Scotia Accord Act* would govern. The interest holder would then pay royalties to the Receiver General if the *Hibernia Reference* applied to lands offshore Nova Scotia and, if the case did not apply, it would pay royalties to the Nova Scotia Offshore Revenue Account.

The Royalty Collection and Administration Agreement makes the trail of royalty payments even more confusing. The Royalty Collection and Administration Agreement provides that the CNSOPB “shall receive all royalties” and “within three (3) working days of receipt, deposit the royalties received with the Receiver General of Canada into the Consolidated Revenue Fund”.⁶⁸ The Minister of Energy, Mines and Resources (Canada) has agreed to “credit the Nova Scotia Offshore Revenue Account with an amount equal to the aggregate of royalties on deposit” and to “pay all amounts which have been credited” to Her Majesty in right of Nova Scotia.⁶⁹ However, an agreement cannot override the statutory obligations to make the payments of royalties, interest and penalties. To the extent of any inconsistency between the *Nova Scotia Accord Act* and the Royalty Collection and Administration Agreement, the *Nova Scotia Accord Act* should govern.

Simply stated, the trail of the royalty payments is not consistent and clarification is required before payment of royalties, interest and penalties can be made. Such clarification will likely be by way of a royalty agreement. Amending the *Nova Scotia Accord Act* and the *Nova Scotia Accord Act* (Nova Scotia) is another alternative, but this requires legislative action by both Canada and Nova Scotia.

IV. Administrative Inter-delegation and Referential Incorporation

1. Crown Contracts

Royalty agreements between the holders of production licence(s) and a government are “crown contracts.” Although the private law of contract is generally applicable to crown contracts, crown contracts themselves are more specifically governed by a distinctive subset of contract law. In this regard, although the Crown has all of the powers of a natural person to contract, these powers are limited by general rules of agency law,⁷⁰ the

68. *Supra* note 60, ss. 2.01(a) and (b).

69. *Ibid.*, s. 2.02.

70. The “Crown” of course, does not act personally. All contracts entered into on behalf of the Crown must be entered into by a person authorized to act as its agent. Once authority is established, the power of the agent to act is governed by the general laws of agency: *Somerville Belkin Industries Ltd. v. Manitoba*, [1987] 5 W.W.R. 553 (Man. Q.B.); see also P. Hogg, *Liability of the Crown* (Toronto: Carswell, 1989) at 168.

supreme law-making authority in our system of government, namely, the legislature,⁷¹ as well as by the supreme law of the land, the constitution.⁷²

A minister has authority to bind the Crown in contract within his or her departmental mandate unless that authority is restricted by or pursuant to a statute.⁷³ Failure to comply with a mandatory restriction may lead to invalidity of the contract, or it may lead to unenforceability of the contract.⁷⁴ Statutory requirements for approval of the Governor in Council, for example, are almost always viewed by the courts as statutory restrictions.⁷⁵ In *Canada (Attorney General) v. Saskatchewan Water Corp.*⁷⁶ the court stated:

It seems clear that s. 7 is dealing with a specific situation — federal-provincial agreements — and it means, and is intended to mean, that the minister is only permitted to enter into such an agreement with the approval of the Governor in Council. The section can be, therefore, looked on as being either a specific expansion of the powers under s. 2(2), or as a specific restriction on those powers whereby the power can be exercised only in a particular way.

In either case, the section constitutes a “statutory restriction” as that phrase is used in the texts and many reported decisions. . . . I conclude that where there is a statutory requirement of an order in council or other formal approval to authorize a contract, any contract which does not meet that requirement is unenforceable.⁷⁷

It would be difficult to argue that s. 22(b) of the *Offshore Petroleum Royalty Act* (which is set out and discussed in more detail in Section V.2) does not constitute a statutory restriction on the minister’s ability to contract regarding royalty agreements. Such subsection describes the circumstances under which the minister may enter into a royalty agreement. Furthermore, the approval of the Governor in Council must be obtained

71. The general rule is that if authority to act is restricted by statute, any actions taken which are contrary to the terms of a statute will be unenforceable against the Crown: *J.E. Verreault & Fils Ltée. v. Quebec (A.G.)* (1975), 57 D.L.R. (3d) 403 (S.C.C.); see also *R. v. CAE Industries*, [1989] 1 F.C. 129 (Fed. C.A.).

72. This issue is not entirely without debate. Hogg, *supra* note 70 at 166, for example, suggests that there is no reason to confine the power to contract within the limits of the power to legislate. The case law, however, suggests otherwise: *Friends of the Island v. Canada*, (1993) 11 C.E.L.R. (N.S.) 253 at 311-19 (F.C. T.D.) where Cullen J. held at 318 that the Crown cannot enter into agreements for purposes that the Constitution says it cannot accomplish.

73. *Supra* note 71.

74. Hogg, *supra* note 70 at 167. See, e.g. *R. v. Transworld Shipping Ltd.*, [1976] 1 F.C. 159, 171 (C.A.).

75. *Gooderham & Worts Limited v. Canadian Broadcasting Corporation*, [1947] 1 W.W.R. 1 (P.C.); *Canada (A.G.) v. Saskatchewan Water Corp.*, [1991] 1 W.W.R. 426 (Sask. Q.B.), rev’d on another point, [1992] 4 W.W.R. 712 (C.A.).

76. *Canada (A.G.) v. Saskatchewan Water Corp.*, *ibid.*

77. *Ibid.* at 454.

concurrently with the minister entering into a royalty agreement. This means that, in the absence of s. 22(b) of the *Offshore Petroleum Royalty Act* authorizing the provincial minister to enter into a royalty agreement, it is doubtful that the minister would have the ability to enter into a royalty agreement based upon the authority she or he derives as head of the Petroleum Directorate. Subsection 34(1) of the *Petroleum and Natural Gas Act* (which is set out and discussed in more detail in Section V.1) does not permit the minister to enter into a royalty agreement. Rather, the statutory restriction requires a royalty agreement to be entered into with the Lieutenant Governor in Council. Such provision describes the circumstances under which the Lieutenant Governor in Council may enter into a royalty agreement. It is therefore arguable that, unless a royalty agreement is entered into pursuant to such subsections, there is no power to enter into a royalty agreement pursuant to the general power to contract under crown contract law.

A royalty agreement entered into pursuant to s. 22(b) of the *Offshore Petroleum Royalty Act* is intended to override the terms of the *Offshore Petroleum Royalty Act* and regulations and establishes the “law” under which the rights and obligations of the parties are governed. The ability to create non-statutory legal rights and obligations that will have the effect of overriding an enactment is essentially a legislative function.

Peter Hogg is highly critical of the case law regarding crown contract law, noting that it works a significant injustice to private contractors who end up bearing the risk and cost of changes in public policy and is not in the long-term best interests of the Crown. Hogg states:

In the long run, however, the doctrines, if taken seriously, would impair the credit of the Crown, forcing the Crown to pay higher prices for everything obtained by contract. The Crown benefits no less than private persons from the principle that contractual undertakings should be reliable.⁷⁸

This criticism notwithstanding, Hogg is unable to assert that the doctrine is inapplicable and concludes that the case law should be “overruled by a court of appropriate seniority.”

2. *Statute Paramountcy*

Under general principles of statutory interpretation, regulations are subordinate to the terms and provisions of their enabling statute. In the event of an inconsistency or excess of jurisdiction, the regulations can be found to be *ultra vires*. As stated by the Supreme Court in *Belanger v. R.*:⁷⁹

78. Hogg, *supra* note 70 at 171.

79. (1916), 54 S.C.R. 265.

[r]egulations cannot operate as amendments of the statute.... A regulation may provide for something to be done consistent with the requirements of the statute, but it is not permitted, under the guise of regulating . . . to amend the statute. . . .

The Saskatchewan Court of Appeal held in *Canada (A.G.) v. Newfield Seeds Ltd.*:⁸⁰

The Governor in Council can in furtherance of the power to pass regulations create regulations of a general or procedural nature which are in furtherance of the powers granted by the Act but cannot grant or create a right or power by regulation which is not contained in or created by the Act. The Governor in Council cannot legislate by regulation in the absence of power to do so which is found in the statute itself.

The power to make regulations is also a legislative function, albeit a function that is usually delegated by the legislature to a minister or the Governor in Council (pursuant to the express terms of the applicable statute). The minister's or Governor in Council's right to make regulations is dependent upon statutory delegation from the legislature, and regulations enacted by the Governor in Council outside of the Governor in Council's regulation-making authority are *ultra vires* and unenforceable. Similarly, regulations enacted by the Governor in Council which purport to override the provisions of a statute, when such power is not delegated, are also *ultra vires* and unenforceable.⁸¹ The minister cannot be delegated the power to enact the regulations under the *Offshore Petroleum Royalty Act*.

Under the *Petroleum and Natural Gas Act*, the Lieutenant-Governor in Council is also constrained to making regulations within the Lieutenant-Governor in Council's authority and cannot make regulations which override the provisions of the statute.

Absent cases of bad faith, it is not the role of the court to pass upon the wisdom of cabinet's intentions in exercising its statutory powers and the courts will not do so lightly. MacEachern C.J., in *B.C. Civil Liberties*,⁸² noted that all courts were bound by the following pronouncement of the Supreme Court of Canada in *Thorne's Hardware Ltd. v. R.*,⁸³ where Dickson J. held:

80. See *Canada (A.G.) v. Newfield Seeds* (1989), 63 D.L.R. (4th) 644 (Sask. C.A.) at 667 [emphasis added].

81. See *Belanger v. R.*, *supra* note 79; *Canada (A.G.) v. Newfield Seeds*, *ibid.*

82. *B.C. Civil Liberties Assn. v. B.C. (A.G.)*, (1988) 24 B.C.L.R. (2d) 189 at 191 (B.C.S.C.) at 191.

83. (1983) 143 D.L.R. (3d) 577 at 580-81 (S.C.C.).

Decisions made by the Governor in Council in matters of public convenience and general policy are final and not reviewable in legal proceedings. Although, as I have indicated, the possibility of striking down an Order in Council on jurisdictional or other compelling grounds remains open, it would take an egregious case to warrant such action.

With regard to the *Accord Acts*, the question that is raised is whether the implementation of that scheme respects the constitutional boundaries in which the two levels of government operate.⁸⁴ In answering that question regard might, in the case of Nova Scotia, be had to the third paragraph of the Nova Scotia Accord which reads as follows:

This *political settlement* of the issues between the Parties has been reached without prejudice to and *notwithstanding their respective legal positions*. It is the intention of the Parties that this settlement survive any decision of a court with respect to ownership or jurisdiction over the Offshore Area.⁸⁵

Although similar wording does not appear in the Newfoundland Accord, it is apparent that the Nova Scotia Accord and the Newfoundland Accord (collectively, the Accords) are political documents that expressly and intentionally disregard the legal positions of the respective governments. However, as agreements, they cannot affect third parties, except to the extent the agreement is implemented by legislation. In that respect, third parties are bound by the legislation and not by the Accords. This was laid out explicitly by the Supreme Court of Canada in 1976.⁸⁶ Clause 4.3 of the *Anti-Inflation Act* provided that the federal minister might, with the approval of the Governor in Council, enter into an agreement with a province providing for the application of the statute in that province, and further specified that, where any such agreement was entered into, the statute would be binding in the province, in accordance with the terms of the agreement.⁸⁷ Various provinces enacted legislation to authorize the appropriate provincial ministers to enter into an agreement with the federal government on the terms set out in Section 4.3 of the *Anti-Inflation Act* (Canada); however, no such legislation was enacted in Ontario. An agreement was entered into between Canada and Ontario,

84. See, for example, *McEvoy v. New Brunswick (A.G.)*, [1983] 1 S.C.R. 704 where the Supreme Court of Canada struck down an arrangement between the two levels of government which involved setting up a unified criminal court in New Brunswick that would have had the power to try all indictable offenses, even those required to be tried by s. 96 judges; See also *Initiative and Referendum Reference* (1916), 27 Man. R. 1 (Man. C.A.); *Canada (A.G.) v. Ont. (A.G.) (Unemployment Insurance)*, [1937] A.C. 355; and *Nova Scotia (A.G.) v. Canada (A.G.)*, [1951] S.C.R. 31.

85. *Supra* note 4 [emphasis added].

86. *Re Reference by the Governor in Council Concerning the Validity of the Anti-Inflation Act*, [1976] 2 S.C.R. 373 [hereinafter *Anti-Inflation Reference*].

87. S.C. 1975, c. 75.

and the issue before the court was whether the agreement made the *Anti-Inflation Act* (Canada) valid provincial law. In holding that the agreement had no such force of law, the Supreme Court of Canada stated:

Where then did this authority come from? It could have come only from independent executive authority because, admittedly, it was not backed by provincial legislative authority . . . I am unable to appreciate how the provincial Executive, *suo motu*, can accomplish such a change...Rather what is at issue is the right of the Crown, although duly protected by an order in council, to bind its subjects in the Province to laws not enacted by the Legislature nor made applicable to such subjects by adoption under authorizing legislation. . . .

The fact that the Crown can contract carries the matter no farther than that . . . What we have here is not a contract in this sense at all, but an agreement to have certain legislative enactments become operative as provincial law

In my opinion, the agreement made between the Government of Canada and the Government of Ontario pursuant to s. 4(3) does not have the effect claimed for it by the Attorney General of Canada and the Attorney-General of Ontario.⁸⁸

The Accords, then, are not “law.” Rather, the legislation purporting to incorporate the terms of the Accords into law must govern. Furthermore, the extent to which the Accords might be used as an interpretive device, based on their role as a “political settlement” operating notwithstanding the “law” is very limited.

The constitutional framework regarding the level of authority of Canada and the provinces has been stated as follows:

The constitution of Canada does not belong either to Parliament, or to the Legislatures; it belongs to the country and it is there that the citizens of the country will find the protection of the rights to which they are entitled. It is part of that protection that Parliament can legislate only on the subject matters referred to it by section 91 and that each Province can legislate exclusively on the subject matters referred to it by section 92. The country is entitled to insist that legislation adopted under section 91 should be passed exclusively by the Parliament of Canada in the same way as the people of each Province are entitled to insist that legislation concerning the matters enumerated in section 92 should come exclusively from their respective Legislatures. . .

Neither legislative bodies, federal or provincial, possess any portion of the powers respectively vested in the other. . . .⁸⁹

88. *Supra* note 86 at 432-34.

89. *Nova Scotia (A.G.) v. Canada (A.G.)*, *supra* note 84 at 34.

Jurisdiction cannot be conferred by consent. The *Hibernia Reference* is authority for the position that Canada has jurisdiction and rights over the mineral and other resources of the seabed and subsoil of the continental shelf in an area offshore Newfoundland. Although the natural resources below the waters off Nova Scotia have not been the subject of constitutional reference, the case law in this area very strongly suggests that constitutional authority over lands past the low water mark along a province's land mass and the mines and minerals thereunder lies exclusively with the federal government under its peace, order and good government powers and as an incidence of international law. In respect of British Columbia, the Supreme Court held:

Legislative jurisdiction with respect to such lands must, therefore, belong exclusively to Canada, for the subject-matter is one not coming within the classes of subjects assigned exclusively to the Legislatures of the Provinces within the meaning of the initial words of s. 91 and may, therefore, properly be regarded as a matter affecting Canada generally and covered by the expression "the peace, order, and good government of Canada"

Moreover, the rights in the territorial sea arise by international law and depend upon recognition by other sovereign States. Legislative jurisdiction in relation to the lands in question belongs to Canada which is a sovereign State recognized by international law...

As with the territorial sea, so with the continental shelf. There are two reasons why British Columbia lacks the right to explore and exploit and lacks legislative jurisdiction:

- (1) The continental shelf is outside the boundaries of British Columbia, and
- (2) Canada is the sovereign State which will be recognized by international law as having the rights stated in the [Geneva] Convention of 1958...

There is no historical, legal or constitutional basis upon which the Province of British Columbia could claim the right to explore and exploit or claim legislative jurisdiction over the resources of the continental shelf.⁹⁰

The court made the following similar findings in the *Hibernia Reference*:

Newfoundland's legislative competence, like that of all other provinces, is confined to legislation operating within the provinces. This restriction is found expressly in s. 92(13) and s. 92A(1) In summary, we conclude:

- (1) Continental shelf rights are, in pith and substance, an extraterritorial manifestation of external sovereignty.
- (2) Canada has the right to explore and exploit in the continental shelf off Newfoundland

90. *Reference Re Ownership of Offshore Mineral Rights* (1967), 65 D.L.R. (2d) 353 at 375-80 (S.C.C.).

(3) Canada has legislative jurisdiction in relation to the right to explore and exploit in the continental shelf off Newfoundland by virtue of the peace, order, and good government power in its residual capacity.⁹¹

The author understands that Nova Scotia does not accept the foregoing analysis and maintains that it alone has the jurisdiction and rights over the mineral and other resources of the seabed and subsoil of the continental shelf in an area off Nova Scotia.

3. *Administrative Inter-delegation and Referential Incorporation*

The concepts of “administrative inter-delegation” between levels of government and “referential incorporation” have been held by our courts to be constitutionally acceptable forms of inter-delegation. It is within the competence of Parliament, for example, to delegate to a provincial agency the power to regulate in respect of matters within exclusive federal jurisdiction.⁹² In *PEI Marketing Board*,⁹³ the federal Parliament gave power to the Governor in Council to delegate the power to regulate the marketing of agricultural products outside the province in interprovincial and export trade to provincial marketing boards already existing and set up to deal with the marketing of agriculture products within the province. It was held to be within federal competence to “adopt as its own” a provincial agency and to authorize it to exercise federal powers alongside with provincial powers. In *PEI Marketing Board*, however, federal legislation enacted by the federal Parliament was applied by the provincial marketing boards, and any delegation of regulation-making power to the board was circumscribed. This is what the *Newfoundland Accord Act* attempts to do.

In 1956, however, the Supreme Court of Canada went further, holding that one level of government could incorporate the legislation of another level of government, by reference, into its own legislation, a technique referred to as “referential incorporation.”⁹⁴

When administrative inter-delegation and referential incorporation are combined, the effect is to enable one level of government to delegate its authority to a provincial body (including a minister) and direct it to apply provincial law. This is what the *Nova Scotia Accord Act* and *Royalty Collection and Administration Agreement* attempt to do. Since the 1950s, this combination of constitutional authority has provided the

91. *Supra* note 1 at 127-29 [emphasis added].

92. See Hogg, *supra* note 70 at 14-22; N. Finkelstein, *Laskin's Canadian Constitutional Law*, 5th ed. (Agincourt: Carswell, 1996); *P.E.I. (Potato Marketing Board) v. Willis*, [1952] 2 S.C.R. 392 [hereinafter *PEI Marketing Board*].

93. *Ibid.*

94. *Ontario (A.G.) v. Scott*, [1956] S.C.R. 137.

basis for a variety of federal-provincial cooperative schemes ranging from inter- and intra-provincial transportation to fisheries to agriculture and the like, all of which have been upheld by the courts.⁹⁵ Hogg notes⁹⁶ that the nadir of this technique is found in the case of *Re Agricultural Products Marketing Act*,⁹⁷ where the Supreme Court of Canada held that the provincial boards could be directed to apply provincial law or could be given federal authority to make regulations.

4. Legislative Inter-delegation

Legislative inter-delegation, however, has not been held to be constitutional. One legislative body cannot enlarge the powers of another by authorizing the latter to enact laws which would have no significance or validity independent of the delegation.⁹⁸ The following passage of Chisholm J. in *Nova Scotia Inter-delegation* on the matter of determining whether or not it was within the legislative competence of Parliament to delegate to the Nova Scotia legislature the authority to make laws in relation to employment matters otherwise within the exclusive legislative jurisdiction of Parliament (and *vice versa*), is instructive:

Section 91 states that it shall be lawful for the Dominion Parliament “to make Laws for the Peace, Order and Good Government of Canada” in relation to all matters not exclusively assigned to the Provinces, which of course, by these very terms states precisely, and by implication as well, that on the subject matters assigned to the Provinces, the Provinces have *exclusive jurisdiction*, and Parliament is not entitled to interfere. The word *exclusively* (which has a plain meaning) as used in these sections indicates which body shall have the power to make laws on the respective list of subjects on which legislation may be passed The use of the word *exclusively* clearly indicates that a settled line of demarcation was intended to be made between the subjects upon which the Parliament of Canada should have power to legislate and those upon which the provincial Legislature might legislate. It has become a maxim in the legal profession and with public men *neither body could increase or decrease or diminish its powers by its own actions*.

95. *Coughlin v. Ontario (Ontario Highway Transport Board)*, [1968] S.C.R. 569; *Re Agricultural Products Marketing Act*, [1978] 2 S.C.R. 1198; *Re Peralta* (1985), 49 O.R. (2d) 705 (C.A.), aff'd [1988] 2 S.C.R. 1045.

96. *Supra* note 70 at 14-22, note 93.

97. [1978] 2 S.C.R. 1198.

98. See the discussion by Hogg, *supra* note 70 at chapter 14; *Re Bill 136 in the Nova Scotia Legislature, 1947 Re Delegation of Legislative Jurisdiction*, [1948] 4 D.L.R. 1 (N.S. S.C.), aff'd [1951] S.C.R. 31 [hereinafter *Nova Scotia Inter-delegation*].

In all the cases dealing with the delegation of power, it must not be overlooked that a legislative body has power to delegate to subordinate bodies of its own creation or selection or to individuals authority to make regulations for the purpose of carrying into execution and making effective its own acts That power is different from a power to cede authority to another independent legislative body.⁹⁹

Taschereau J. in the Supreme Court of Canada held in respect of the case that there was no power of delegation, and further, that there was no power to accept such delegation:

Parliament or the Legislatures must delegate in certain cases their powers to subordinate agencies, but that it has never been held that the Parliament of Canada or any of the Legislatures can abdicate their powers and invest for the purpose of legislation, bodies which by the very terms of the *B.N.A. Act* are not empowered to accept such delegation, and to legislate on such matters.¹⁰⁰

5. *Distinguishing Between Legislative and Administrative Inter-delegation*

Distinguishing between legislative and administrative inter-delegation is not always a simple matter. Unlike the constitutional authority granted to the provinces, which has an associated territorial boundary (in the province), federal constitutional powers are typically not “territorially defined” within Canada. The issues that the two levels of government have had to face, then, is how to determine where one jurisdiction ends and the other begins. Administrative inter-delegation and referential incorporation have largely done away with this difficult question. However, in relation to the offshore, the issues are different. The offshore is not “in the province.” It is one of the few territorially defined federal constitutional powers.

In respect of the offshore, administrative delegation and referential incorporation do not change the proposition outlined in *Nova Scotia Inter-delegation*. These principles only work if the provincial legislation setting up the provincial agency and regulatory regime are within the competence of the provincial government and for its own purposes in the first instance. As Laskin explains:

There is no unconstitutional delegation involved where there is no enlargement of the legislative authority of the referred legislature, but rather a borrowing of provisions which are within its competence and which were enacted for its own purposes, and which the referring legislature could have validly spelled out for its own purposes.¹⁰¹

99. [1948] 4 D.L.R. 1 at 6-8 (N.S. S.C.) [emphasis added].

100. *Nova Scotia Inter-delegation*, *supra* note 98 at 44.

101. *Supra* note 92 at 43.

The issue was more directly set out by Chisholm J. in *Nova Scotia Inter-delegation*, when he quoted the following passage from *Clement's Canadian Constitution*: "Provincial legislation which, *ex hypothesi*, requires federal legislation to support it is not legislation at all."¹⁰²

If we examine the various cases which have upheld administrative inter-delegation and referential incorporation, paying particular attention to how they are structured, and compare this to the situation in the offshore and the structure of the *Accord Acts* and the *Provincial Accord Acts*, it will be seen that the situation in the offshore is distinct. The provincial government has no authority to legislate in relation to any matter within the offshore, to the extent it is not "within the province."

6. *Analysis of Administrative Inter-delegation and Referential Incorporation Cases*

Although the manner in which provincial (or federal) legislation is referentially incorporated in each of the following cases is different, common to each of the following cases is the fact that both the federal and provincial governments had some basis on which to claim constitutional authority over one or more aspects of the subject matter of the case.

a. *Coughlin*

In *Coughlin v. Ontario (Ontario Highway Transport Board)*,¹⁰³ the Supreme Court of Canada held and affirmed the decision of the lower Ontario courts that the delegation by the federal Minister of Transport of the minister's regulatory authority over extra-provincial transportation to a provincial board was constitutional. There was nothing unconstitutional in the federal adoption of provincial laws in force in Ontario in relation to the licensing of local undertakings or their application to extra-provincial transport operating in a province.

Section 3 of the federal *Motor Vehicle Transport Act* provided:

3(1) Where in any province a licence is by the law of the province required for the operation of a local undertaking, no person shall operate an extra-provincial undertaking in that province unless he holds a licence issued under the authority of this Act.

3(2) The provincial transport board in each province may in its discretion issue a licence to a person to operate an extra-provincial undertaking into or through the province upon the like terms and conditions and in the like manner as if the extra-provincial undertaking operated in the province were a local undertaking.¹⁰⁴

102. *Supra* note 98 at 9, Hogg, *supra* note 70 at 380.

103. *Supra* note 95.

104. S.C. 1953-54, c. 59.

The court read the provisions of s. 3(1) to mean that the licence to operate an extra-provincial undertaking was to be issued under the authority of the federal *Motor Vehicle Transport Act*. The federal licence that would be issued to them under the *Motor Vehicle Transport Act* would be the licence referred to in s. 3(2) – that is, a licence issued by a provincial board. Although the argument was made by counsel for Coughlin that this was a case of unconstitutional inter-delegation, the Ontario High Court disagreed, noting that the federal legislation did not confer any additional powers on the provincial legislature. The court reasoned:

In the *Motor Vehicle Transport Act*, Parliament could have provided for the passing of Regulations setting out the procedures to be followed and conditions to be attached to extra-provincial licences. Instead it saw fit to adopt, and make applicable to extra-provincial transport, provincial laws in force relating to the licensing of local undertakings.¹⁰⁵

The licensing scheme originally established by the province was constitutionally valid under s. 92(13) of the *Constitution Act, 1867* as a matter affecting property and civil rights in the province; hence, the federal government could adopt it as its own and delegate to the province the power to regulate extra-provincial transportation in the province.

b. *Re Shoal Lake Band*

The issue before the courts in *Re Shoal Lake Band*¹⁰⁶ involved constitutional authority over inland water fisheries. Parliament's authority in relation to fisheries is established under s. 91(12) of the *Constitution Act, 1867* to regulate activity over inland fisheries. At the same time, s. 92 of the *Constitution Act, 1867* gives the provincial governments authority, as proprietors of Crown lands, to legislate in relation to the management and sale of public lands in the province, property and civil rights in the province, and generally all matters of a merely local or private nature. When the provincial government attempted to issue licences that established quotas on the licensee for catching fish, the Shoal Lake Band challenged the constitutionality of the legislative scheme established by the federal and provincial governments to regulate fishing.

The federal government enacted the *Fisheries Act*¹⁰⁷ which, in s. 5(4), provided that the federal Governor in Council may, by order, designate as fisheries officers, for the purposes of this Act, any person or classes

105. *Coughlin v. Ontario (Ontario Highway Transport Board)*, [1966] 1 O.R. 183 at 191 (H.C.).

106. *Shoal Lake Band of Indians and the Queen in Right of Ontario* (1979), 101 D.L.R. (3d) 132 (Ont. H.C.) [hereinafter *Re Shoal Lake Band*].

107. R.S.C. 1970, c. F-14.

thereof that he deems qualified to act in that capacity. Pursuant to that section, the Governor in Council designated provincial conservation officers under Ontario's *Game and Fish Act*.¹⁰⁸ At the same time, the *Fisheries Act* authorized the Governor in Council to make regulations "prescribing the powers and duties of persons engaged or employed in the administration or enforcement of this Act and providing for the carrying out of those duties and powers" and "authorizing a person engaged or employed in the administration or enforcement of this Act to vary any close time or fishing quota that has been fixed by regulation." Pursuant to these powers, the Governor in Council enacted the *Ontario Fisheries Regulations*.¹⁰⁹ Section 2 of these defined certain relevant fishery terms in a referential manner, as follows:

- (j) "Department" means the Ministry of Natural Resources of Ontario.
- (q) "licence" means an instrument issued under the *Game and Fish Act* . . . or the regulations thereunder, conferring upon the holder the privilege to do the things set forth in it, subject to the conditions, limitations and restrictions contained in it and the Act, the regulations thereunder and these Regulations
- (r) "Minister" means the Minister of Natural Resources for Ontario

The *Ontario Fisheries Regulations* then specified:

- 3(1) Except as provided in these Regulations, no person shall fish or take fish from any of the waters of the province.
- 12(1) Subject to subsection (3) no person shall, except under a licence prescribed therefore, take or attempt to take fish by any means.
- 31(4) The Minister may, in any commercial fishing licence, designate
 - (a) the waters and the species, size and quality of fish for which the licence is valid
- 31(5) The Minister may in any licence impose such terms and conditions as he deems proper and that are not inconsistent with these Regulations.

In upholding the validity of the administrative inter-delegation, the court held

In my view, the *Fisheries Act* (Canada) and the Ontario Fisheries Regulations passed pursuant to the federal Act, constitute the substantive law pertaining to licences for commercial fishing in the waters of Ontario. The federal Act by means of the Regulations passed pursuant to it, adopted the machinery provided by the *Ontario Game and Fish Act* as to the issuance of the commercial fishing licence.

108. R.S.O. 1970, c. 186.

109. S.O.R. 163-157.

It is apparent that the *Fisheries Act* (Canada) contemplates the imposition of restrictions on fishing for the purposes of management, control, conservation and protection of fish. Section 34 of the federal Act specifically provides that Regulations may be made for those purposes. The requirement of licences as a method of control is also contemplated by the *Fisheries Act* (Canada)...

The expression “issued under the *Game and Fish Act*, 1961-62, Ontario” should, in my view, be interpreted to mean in the manner provided by the Ontario Act. The substantive requirement for the licence is provided for in the Ontario Fishery Regulations.¹¹⁰

The court held further that in the circumstances, not all of the provisions of the Ontario *Game and Fish Act* were applicable. Subsection 5(4) of the federal *Fisheries Act* specifically provided that the federal minister could designate any person to issue a licence, and, by order in council, delegate that authority to provincial conservation officers. The Ontario *Game and Fish Act*, however, specified that a licence could be issued by the issuer of a licence (a provincial conservation officer), his family and employees. On that point, the court held that the federal *Fisheries Act* was paramount. That provision of Ontario’s *Game and Fish Act* which authorized persons other than provincial conservation officers to issue licences was held not to apply to federal licences issued under the authority of the federal *Fisheries Act* as it conflicted with the express provisions of s. 5(4) of the *Fisheries Act*.

To the extent that s. 22(c) of the *Offshore Petroleum Royalty Act* is broader in application than s. 100 of the *Nova Scotia Accord Act*, by specifying that the minister can delegate any “ministerial power, duty or function” pursuant to the *Offshore Petroleum Royalty Act*, it is in conflict with the legislative authority granted by the federal Parliament under s. 100 of the *Nova Scotia Accord Act* and therefore inapplicable, just as it was in *Re Shoal Lake Band*.

Subsection 22(c) of the *Offshore Petroleum Royalty Act* provides the provincial government with the power to enter into a collection and administration agreement with the CNSOPB and the federal government in the manner specified in the *Anti-Inflation Reference*. Giving it a broader meaning would potentially conflict with the power granted by Parliament to the Government of Canada under s. 100 of the *Nova Scotia Accord Act*. In such a case, s. 100 of the *Nova Scotia Accord Act* would prevail in any event.

110. *Supra* note 106 at 141-42.

c. *Peralta*

*Peralta and the Queen in right of Ontario*¹¹¹ involved the *Fisheries Act* (Canada) and the provincial ministers' ability to impose quotas. The court's view was that the quota was inserted by the provincial minister pursuant to the minister's delegated powers under the federal *Ontario Fishing Regulations*, and the quotas were thus established under the *Fisheries Act*. In this case, however, the court elaborated somewhat more on the lawfulness of the sub-delegation involved, holding that

[t]here is no question that under s-s. 92(9) and s-s. 92(14) of the *Constitution Act, 1867* the province had the legislative power to license and to impose fees for those licences. The Ontario regulation goes no further than that. It was agreed that the licence, now in Form 24, is blank and that it is the Minister who sets and inserts the individual species quotas in the space provided under the authority of ss. 2(1), 29(4)(a) and (5) of the *Ontario Fishery Regulations* quoted above. The quota is inserted, in my view, as I stated earlier, pursuant to the federal legislation and not pursuant to provincial legislation

This conclusion does not, of course, answer the fundamental question, is there authority to subdelegate? Section 34(g) of the *Fisheries Act* allows for the Governor in Council to make regulations "respecting the terms and conditions under which a lease or licence may be issued" [emphasis added]. In dealing with this subsection the Divisional Court judge quoted the wording of the subsection as it stood prior to the amendment That wording was "prescribing the terms and conditions under which a licence or lease is to be issued"....The amendment must have had some purpose and significance and, in my opinion, Parliament was ensuring that the Governor in Council was empowered to delegate to others the administration of its regulations.¹¹²

According to the court then, the use of "prescribe" would have implied that Parliament did not intend to empower the Governor in Council with the ability to delegate the Governor in Council's authority to enact regulations. The powers of the Lieutenant-Governor in Council under the *Petroleum and Natural Gas Act*¹¹³ and the Governor in Council under the *Offshore Petroleum Royalty Act*¹¹⁴ include the power to "prescribe" the royalty, and various other related aspects.

In *Seafarers' International Union of Canada (Labour Relations Board)*,¹¹⁵ the Federal Court of Appeal specifically addressed the issues of delegation of legislative authority and referential incorporation in the context of s. 157 of the *Nova Scotia Accord Act*. Subsection 157(2)

111. *Supra* note 95.

112. *Ibid.* at 715-17 [emphasis added].

113. *Supra* note 9, ss. 32, 33 and 39.

114. *Supra* note 18, s. 23.

115. [1993] F.C.J. No. 458 (QL).

incorporated by reference Nova Scotia's social legislation and any regulations made thereunder to marine installations or structures within the offshore. Under the relevant Nova Scotia legislation, the Minister of Mines and Energy had the authority to approve regulations made by the Governor in Council. At issue was whether such "approval authority" amounted to a legislative delegation of power. The Federal Court of Appeal held that it did not, on two bases: first, there was no enlargement of the legislative authority of the provincial Parliament, consequently, there was no legislative delegation of authority to the province; second, and to us, more importantly, referential incorporation of otherwise constitutionally valid provincial legislation is a constitutionally sound technique, even to the extent that it includes future regulations enacted under the provincial legislation.

Accordingly, the Nova Scotia social legislation referred to in the *Nova Scotia Accord Act* is constitutionally valid legislation enacted by the province in relation to matters within its jurisdiction. The regulation-making powers of the provincial Governor in Council and the approval of the minister, are subject to s. 157(3) of the *Nova Scotia Accord Act*. Subsection 157(3) restricts the scope of application of the provincial legislation by stating that any provision in any Act or in any regulations that "is in relation to a matter respecting which a regulation may be made under paragraph 153(1)(d), (m), (o) or (p) of this Act . . . or under any provision of this Act respecting occupational health or safety does not apply on marine installations or structures . . ." These exceptions show that although the provincial social legislation may be applied to marine installations in the offshore, they are applied only to the extent they have been incorporated into the federal legislation and not in their entirety. Moreover, the application of the provincial legislation to marine installations is, effectively, the application of federal legislation by virtue of s. 157(2).

7. Interplay of the Accord Acts, the Provincial Accord Acts and the Royalty Acts

Unlike the above-noted cases, where the provinces could lay claim to having constitutional authority to enact the legislation which they enacted, there is no basis for the Government of Newfoundland and Labrador and little basis for the Government of Nova Scotia to lay claim to constitutional authority over the offshore. The natural resources in the offshore are not "in the province." In that respect, the interplay of the *Newfoundland Accord Act*, the *Newfoundland Accord Act* (Newfoundland) and the *Petroleum and Natural Gas Act* and, likewise, the *Nova Scotia Accord Act*, the *Nova Scotia Accord Act* (Nova Scotia) and the *Offshore Petroleum*

Royalty Act must result in federal legislation and regulations being implemented in the offshore area (*i.e.* referential incorporation and administrative delegation of powers). If such schemes are viewed as legislative inter-delegations of power (*i.e.* provincial law supported by federal legislation), the scheme will be invalid.

In effect, all powers, including the power of delegation, must derive from the federal Parliament under the terms of the *Accord Acts*. The provincial legislation, incorporated thereunder must be interpreted from a federal, rather than a provincial, perspective.

8. *Accord Acts - the Application of Newfoundland and Nova Scotia Legislation*

It appears that the *Accord Acts*¹¹⁶ were drafted, in part, to attempt to deal with the issue of the unconstitutional delegation or ceding of legislative authority over the offshore from the Government of Canada to the Government of Newfoundland and Labrador and the Government of Nova Scotia, respectively. It had to be made clear that the *Petroleum and Natural Gas Act* and the *Offshore Petroleum Royalty Act* (collectively the *Royalty Acts*) were federal legislation. Moreover, we have to read all powers delegated to the CNOBP, CNSOPB, the Government of Newfoundland and Labrador and Government of Nova Scotia as deriving from the *Accord Acts*.

Subsection 8(1) of the *Newfoundland Accord Act* (Newfoundland) is problematic. It provides that the *Newfoundland Accord Act* (Newfoundland) applies within the offshore area. As there is no basis for Newfoundland to lay claim to having constitutional authority in the offshore, the entire provisions of that statute might be unconstitutional. If the *Newfoundland Accord Act* (Newfoundland) were found to be unconstitutional, the creation of the CNOBP and the reciprocity of the federal-provincial legislation could be in disarray.

The royalty to Canada and the obligation of holders of a share in a production licence are expressly reserved pursuant to the *Accord Acts*.¹¹⁷ Those sections require us to read the *Royalty Acts* as if they were federal acts emanating from the federal Parliament. Sections 31, 32 and 33 of the *Petroleum and Natural Gas Act* would then read:

31. A royalty determined under this part is reserved to *Her Majesty in right of Canada* on all petroleum recovered under this Act.

116. *Newfoundland Accord Act*, *supra* note 5, s. 97(4) and *Nova Scotia Accord Act*, *supra* note 14, s. 99(3).

117. *Newfoundland Accord Act*, *ibid.*, s. 97(2); *Nova Scotia Accord Act*, *ibid.*, s. 99(1).

32. Petroleum produced according to a lease under this Act is subject to, and each holder of a share in the lease is liable for and shall pay to *Her Majesty in right of Canada*, basic royalty in an amount and in a manner prescribed by the regulations.

33. Each holder of a share of a lease is liable for and shall pay to *Her Majesty in right of Canada* an incremental royalty that may be prescribed by the regulations.¹¹⁸

Subsection 3(1) of the *Offshore Petroleum Royalty Act* would then read:

3.(1) There is hereby reserved to *Her Majesty in right of Canada*, and each holder of a share in a production licence is liable for and shall pay, in accordance with the regulations, such royalties as may be prescribed, at the rates prescribed, in respect of petroleum produced from the offshore area and in respect of the periods prescribed.¹¹⁹

As noted in Subsection II.3.b, ss. 31 and 32 of the *Petroleum and Natural Gas Act* are problematic. Production licences are not really “under this Act;” rather, they are issued pursuant to or “under” the *Newfoundland Accord Act*.

Under the *Petroleum and Natural Gas Act* and the *Offshore Petroleum Royalty Act*, the power to make regulations prescribing the royalty is given to the Newfoundland Lieutenant-Governor in Council and the Nova Scotia Governor in Council respectively, and while subordinate to such acts, the regulations nonetheless form part of the enactment adopted by Parliament. In that regard, the regulations are also “federal regulations.” This is probably not a delegation of authority from the federal Parliament to the provincial Lieutenant-Governor in Council or Governor in Council to enact regulations on its behalf as the provincial regulations are also made to apply. The adoption of the provincial regulations as “federal regulations,” however, is a limitation on the authority of the federal Governor in Council to enact regulations which conflict with those prescribed under the *Petroleum and Natural Gas Act* and the *Offshore Petroleum Royalty Act* by the respective provincial Lieutenant-Governor in Council and Governor in Council. Furthermore, the modification of the provincial minister for the federal minister¹²⁰ as required by the *Nova Scotia Accord Act* will be troublesome with regard to the use of “Minister” throughout in the *Offshore Petroleum Royalty Regulations*.¹²¹ The federal minister presumably delegated the powers, duties and functions back to the provincial minister pursuant to the Royalty Collection and Administration Agreement in conjunction with s. 22(c) of the *Offshore*

118. Compare *supra* note 9, ss. 31-33 [emphasis added].

119. Compare *supra* note 18, s. 3(1) [emphasis added].

120. *Supra* note 14, s. 99(3)(c).

121. *Offshore Petroleum Royalty Regulations*, N.S. Reg. 71/99, approved by Order in Council O.I.C. 1999-337 (17 June 1999).

Petroleum Royalty Act, but it cannot, and did not, delegate the power to prescribe regulations.

The language in s. 22(c) of the *Offshore Petroleum Royalty Act* which permits the minister to delegate “any ministerial power, duty or function” conflicts with the more limiting language in s. 100 of the *Nova Scotia Accord Act*. The reference to the “federal government” in s. 22(c) of the *Offshore Petroleum Royalty Act* which is referentially incorporated is also problematic. It is further noted that the Royalty Collection and Administration Agreement is terminable on six months’ notice.¹²² The whole Nova Scotia scheme falls if the Royalty Collection and Administration Agreement is terminated.

The *Accord Acts*¹²³ provide that the royalty payable under the *Accord Acts* in respect of the offshore area is the same as that prescribed in respect of, in the case of Newfoundland, the area within the Province of Newfoundland, and in the case of Nova Scotia, within the Nova Scotia lands.

With respect to s. 34(1) of the *Petroleum and Natural Gas Act* and s. 22(b) of the *Offshore Petroleum Royalty Act*, the party entering into a royalty agreement is the Lieutenant-Governor in Council in the case of Newfoundland or the “Minister” as approved by the Governor in Council in the case of Nova Scotia. The federal Governor in Council’s powers would not be taken as having been delegated, provided that the “approval of the Governor in Council,” is read as the approval of the *federal* Governor in Council. However, that is not the practice. The Hibernia Development Project Royalty Agreement, the Cohasset/Panuke Royalty Agreement and the Sable Offshore Energy Royalty Agreements were not approved by the federal Governor in Council. Furthermore, such agreements were not entered into with the federal Governor in Council or the federal minister, which seems to be contemplated by the *Accord Acts*.¹²⁴ Any agreement entered into pursuant to s. 34(1) of the *Petroleum and Natural Gas Act* and s. 22(b) of the *Offshore Petroleum Royalty Act* must in substance be a “federal agreement” or it risks being invalid. As a result, the Hibernia Development Project Royalty Agreement expressly states that it is not entered into pursuant to the *Petroleum and Natural Gas Act*.

122. *Supra* note 60, s. 6.01.

123. *Supra* note 6, s. 97(2); *supra* note 15, s. 99(1).

124. *Newfoundland Accord Act*, *supra* note 5, s. 97(4) and *Nova Scotia Accord Act*, *supra* note 14, s. 99(3).

There is some doubt as to the power of the federal minister to delegate all of the minister's powers under the *Nova Scotia Accord Act* to the provincial minister, including the power to enter into agreements with holders of a share in a production licence. Division IV of Part II of the *Nova Scotia Accord Act* does not contain a provision similar to s. 215 of the *Nova Scotia Accord Act* (Nova Scotia) which, in relation to the administration of a tax administration agreement, specifically authorizes the provincial minister to "perform the duties and exercise any power or discretion that the Minister . . . has" under Part IV.

The Royalty Collection and Administration Agreement appears to involve something less than a full delegation of ministerial powers.

V. Royalty Agreements

1. Newfoundland

The *Petroleum and Natural Gas Act* permits the Lieutenant-Governor in Council to enter into a royalty agreement with the holder(s) of a lease. Subsections 34(1) and (2) read:

34(1) A basic royalty, incremental royalty or a royalty in kind reserved to the Crown in right of the province on petroleum may be in accordance with an agreement entered into by the *Lieutenant-Governor in Council* with the holder of a share of a lease or the holders of all shares of a lease.

(2) Where an agreement referred to in subsection (1) is entered into by the *Lieutenant-Governor in Council*, that agreement shall have the full effect of law as if set out specifically in this Act and shall prevail notwithstanding another provision of this Act with the exception of subsection (3).¹²⁵

A royalty agreement was entered into regarding the Hibernia Development Project¹²⁶, but it was not entered into pursuant to s. 34(1) of the *Petroleum and Natural Gas Act*. As a result of the interpretative issues discussed above in Part IV, the following clause 1.2 was included in the Hibernia Development Project Royalty Agreement:

125. *Supra* note 9, s. 34(1)(2) [emphasis added].

126. Hibernia Development Project Royalty Agreement made the 1st day of September, 1990 among Her Majesty the Queen in right of the Province of Newfoundland, Mobil Oil Canada Properties, Chevron Canada Resources, Petro-Canada Hibernia Partnership, Gulf Canada Resources Limited, Mobil Oil Canada, Ltd., Chevron Canada Resources Limited and Petro-Canada Inc. [hereinafter Hibernia Development Project Royalty Agreement]. Note that ss. 25(1) and (2) of the *Petroleum and Natural Gas (Amendment) Act*, S.N. 1986 c. 40 read:

25(1) A basic royalty, incremental royalty or a royalty in kind reserved to the Crown in right of the province on petroleum may be in accordance with an agreement entered into from time to time by the Lieutenant-Governor in Council with the holder of a lease.

(2) In the event that an agreement referred to in subsection (1) is entered into by the Lieutenant-Governor in Council, that agreement shall have the full force and effect of law as if set out specifically in this Act and shall prevail notwithstanding any other provision of this Act.

- (i) this Agreement *has not been entered* into by the Province pursuant to subsection (1) of section 25 or any other provision of the Newfoundland Petroleum and Natural Gas Act;
- (ii) *has not been entered* into by the Province pursuant to any provision of the Federal Accord Act or the Provincial Accord Act; and
- (iii) *the Royalty Share* payable by the Project Owners and the Licensees pursuant to this Agreement *is not paid* to the Province pursuant to subsection (2) of section 97 or any other provision of the Federal Accord Act or any provision of the Provincial Accord Act.

The Minister of Natural Resources, with the approval of the Governor in Council, was given the power to enter into agreements regarding provisions for the payment of a net profits interest. The relevant portions of the *Hibernia Development Project Act* read as follows:

3(1) The Minister may, with the approval of the Governor in Council, enter into one or more agreements on behalf of Her Majesty in respect of the Hibernia Development Project.

(2) The agreements entered into under this section may include . . .

(c) provisions for the payment of a net profit interest to Her Majesty¹²⁷

No agreements have been entered into pursuant to the foregoing powers. The Government of Newfoundland and Labrador and the participants in the Terra Nova Development Project have been negotiating a royalty agreement modeled after the Hibernia Development Project Royalty Agreement for several years. As of November 1, 2001, an agreement had not been finalized and the execution of the agreement is not imminent. It is contemplated that, when executed, such an agreement will, in like manner to the Hibernia Development Project Royalty Agreement, avoid the constitutional quagmire, inconsistencies and questions discussed in this article and will include a provision similar to clause 1.2.

2. Nova Scotia

The *Offshore Petroleum Royalty Act* permits the minister to enter into an administration or a royalty agreement with the holder of the share in a production licence. Subsections 22(a) and (b) read:

The Minister may

- (a) enter into an agreement with each holder of a share in a production licence respecting administrative and operational matters, such agreement to be subject to the regulations respecting administrative and operational matters necessary for carrying out this Act and to an agreement referred to in clause (b);

127. S.C. 1990 c. H-3.7 ss. 3(1) and (2)(a).

(b) with the approval of the Governor in Council, enter into an agreement with each holder of a share in a production licence pertaining to any matter in respect of which the Governor in Council may make regulations and providing that in the event of an inconsistency between the agreement and the regulations, the agreement prevails¹²⁸

A royalty agreement was entered into in respect to the Cohasset/Panuke Project.¹²⁹

Nova Scotia entered into five separate royalty agreements regarding the Sable Offshore Energy Project.¹³⁰

The *Offshore Petroleum Royalty Act* provides:

23(1) The Governor in Council may make regulations for carrying out the purposes and provisions of this Act and, without restricting the generality of the foregoing, may make regulations . . .

(c) exempting, conditionally or unconditionally, any person or persons of any class from the payment of, in whole or in part, any royalty pursuant to this Act or exempting any petroleum produced from the offshore area from the application of this Act¹³¹

128. *Supra* note 18, ss. 22(a) and (b).

129. LASMO-Province of Nova Scotia Royalty Agreement for Cohasset/Panuke Project between Her Majesty the Queen in right of the Province of Nova Scotia represented by the Minister of Natural Resources and LASMO Nova Scotia Limited (1992) [hereinafter Cohasset/Panuke Project Royalty Agreement].

130. They are: (a) Sable Energy Project Royalty Agreement among Her Majesty the Queen in right of the Province of Nova Scotia, as represented by the Minister responsible for the *Offshore Petroleum Royalty Act* and the Petroleum Directorate, Mobil Oil Canada Properties and Sable Offshore Energy Inc. made this 27 day July, 1999; (b) Sable Energy Project Royalty Agreement among Her Majesty the Queen in right of the Province of Nova Scotia, as represented by the Minister responsible for the *Offshore Petroleum Royalty Act* and the Petroleum Directorate, Shell Canada Limited and Sable Offshore Energy Inc. made this 27 day July, 1999; (c) Sable Energy Project Royalty Agreement among Her Majesty the Queen in right of the Province of Nova Scotia, as represented by the Minister responsible for the *Offshore Petroleum Royalty Act* and the Petroleum Directorate, Imperial Oil Resources Limited and Sable Offshore Energy Inc. made this 27 day July, 1999; (d) Sable Energy Project Royalty Agreement among Her Majesty the Queen in right of the Province of Nova Scotia, as represented by the Minister responsible for the *Offshore Petroleum Royalty Act* and the Petroleum Directorate, Mosbacher Operating Ltd. and Sable Offshore Energy Inc. made this 27 day July, 1999; and (e) Sable Energy Project Royalty Agreement made this 1 day May, 2000 among Her Majesty the Queen in right of the Province of Nova Scotia, as represented by the Minister responsible for the *Offshore Petroleum Royalty Act* and the Petroleum Directorate and Nova Scotia Resources (Ventures) Limited. Approved by the Governor in Council by Order in Council 1999-338 (17 June 1999) [hereinafter, collectively, Sable Energy Project Royalty Agreements].

131. *Supra* note 18, s. 23(1)(c).

The Governor in Council has enacted regulations exempting Nova Scotia Resources (Ventures) Limited from the payment of royalties provided for in the royalty agreement.¹³² The constitutional validity of these regulations in light of s. 99(1) of the *Nova Scotia Accord Act* and equalization and transfer payment issues as between Canada and Nova Scotia is beyond the scope of this article.

The Sable Offshore Energy Project Royalty Agreements purposely work around certain of the provisions of the *Nova Scotia Accord Act*, the *Nova Scotia Accord Act* (Nova Scotia) and the *Offshore Petroleum Royalty Act*. The minister provides therein certain representations, warranties and indemnities to the Sable Offshore Energy Project participants to clarify the constitutional quagmire, inconsistencies and issues discussed in this article. The provisions are severable and are meant to stand alone as a separate private Crown contract.

3. *Generally*

The foregoing royalty agreements by their very nature are detailed, complex and very difficult to read and understand. The Hibernia Development Project Royalty Agreement took more than a year to negotiate and execute. The Sable Offshore Energy Project Royalty Agreements took a year and a half to negotiate and execute. The Terra Nova Development Project royalty agreement is still being negotiated after several years, with no end in sight. Extensive costs are incurred in negotiating a detailed royalty agreement. High-level human resources are required to effect such a royalty agreement. The complex *Accord Acts*, *Provincial Accord Acts*, *Royalty Acts* and numerous regulations thereunder in some important instances create more issues than they resolve. The Government of Canada has little ongoing involvement with the natural resources of the east coast offshore areas and seemingly little interest in royalty issues. The balance of this article will examine the issue of whether a generic offshore royalty regime is a better alternative.

VI. *Generic Regulations*

1. *Newfoundland*

Newfoundland has announced the basic fiscal terms of generic offshore royalty regulations.¹³³ However, since the 1996 announcement, there has been little further communication with industry and no draft of specific

132. *Nova Scotia Resources (Ventures) Limited Royalty Exemption Regulations*, N.S. Reg. 27/2000. Approved by Order in Council 2000-87 (1 March 2000).

133. Government of Newfoundland and Labrador, Mines and Energy, Press Release, "Royalty Regime" (13 June 1996).

regulations has been developed. The full fiscal and commercial generic royalty regulations for the Newfoundland offshore appear to be years away.

2. *Nova Scotia*

Concurrent with the negotiation and execution of the Sable Offshore Energy Project Royalty Agreements, Nova Scotia finalized with industry (including the Sable participants) the *Offshore Petroleum Royalty Regulations*.¹³⁴ A great deal of effort and expense was incurred by Nova Scotia in finalizing the *Offshore Petroleum Royalty Regulations*. Although it will be suggested at the conclusion of this article that it will be necessary in all situations to execute a royalty agreement regarding the production of petroleum in the east coast Canada offshore areas, the Nova Scotia generic offshore royalty regime will be useful in reducing the costs and the time frame in finalizing and executing subsequent royalty agreements. Such royalty agreements will, in the author's opinion, be easier to negotiate and will involve lower costs and require fewer human resources. The enactment of the *Offshore Petroleum Royalty Regulations* provides a significant advantage to Nova Scotia in attracting capital to develop the offshore natural resources.

VII. *Specific Provisions In Royalty Agreements*

Generic offshore royalty regulations, by their very nature, are geared to a type of project which does not exist. A government which causes generic offshore royalty regulations to be enacted is caught between the proverbial rock and a hard place. The generic offshore royalty regime should be a basic and predictable system (fiscally, commercially and politically). It should be highly profit sensitive and account for all exploration, development and operating costs. The fiscal terms must provide a competitive rate of return for the owners of the non-renewable resource. At the same time, the developer of the non-renewable resource must receive a competitive rate of return on the invested capital, taking into consideration the considerable risks involved. It is the author's opinion that the fiscal terms of generic offshore royalty regulations will always be conservative and tilted more or less in favour of the owner of the non-renewable resource. At the time a project is developed, the specific nature of the project and the peculiar risks involved in developing and producing the non-renewable resource will invariably necessitate the finetuning or more drastic amendment of the fiscal and commercial terms introduced in the generic offshore royalty regulations.

134. *Supra* note 121.

A generic offshore royalty regime cannot include all of the fiscal and commercial terms which are required by a developer of the non-renewable resource. If all of the developer's terms were included, it might even be suggested that the province/Canada has not retained sufficient fiscal returns for the province/Canada.

Part VII will examine briefly some commercial and fiscal terms which either are not included in the *Offshore Petroleum Royalty Regulations* or, based on the author's review of the existing and draft east coast Canada offshore royalty agreements, might not be achieved without the entering into of a royalty agreement.

1. *Fiscal Terms*

a. *Costs*

In any net profits royalty regime, the determination of pre-development, capital, operating and netback costs is critical. A royalty agreement may tailor the costs that are deductible in calculating the royalty or the payout of the royalty tiers to the particular project. An interest holder may not be limited to the costs incurred for the joint account of all of the participants in the project. Abandonment costs incurred after cessation of production might be carried back and deducted against costs when the net profits royalty was payable. The fair market costs paid to captive insurers and costs paid to third parties who share in reservoir risk might be allowed.

b. *Pre-development Costs*

There is significant risk in drilling for oil and gas, especially in the offshore. Not all wells are successful. Even if successful, the production of the resource might not be commercial due to commodity prices, the kind, quality or location of the resource, the capital or throughput cost of facilities, and environmental, political and many other issues. Very few exploration wells will ever produce. Even if hydrocarbons are found, it is often necessary to drill development wells to optimally produce the reserves. As a result, most exploration wells are abandoned. A generic offshore royalty regime that only takes into account successful efforts may ignore significant development costs and understate the overall commercial risks. The disallowance of such costs may have little or no effect on the development of commercial discoveries which have already been discovered. However, the disallowance of such costs will ultimately adversely affect the drilling of further exploratory wells. Where a royalty agreement is executed, the inclusion of pre-development costs is a negotiated amount (although something below the actual costs incurred). The rate of return and the effective date of the expenditure of the pre-development costs are also negotiated terms. A generic offshore royalty

regime might lowball the pre-development costs and the rate of return allowed thereon.

c. *Disallowed Costs*

Even though a developer of a non-renewable resource has incurred a reasonable cost in developing a project, it might be politically expedient to disallow certain of those costs. Interest, financing costs and depreciation should obviously be disallowed where a rate of return is provided. In the *Offshore Petroleum Royalty Regulations*,¹³⁵ a long list of disallowed costs has been included. Many of these disallowed costs might be refined and tailored to a particular project so that they are not disallowed. Furthermore, rather than disallow any cost not provided for in the generic offshore royalty regulations, the basket or catch-all¹³⁶ might be that all costs are allowed, rather than providing that all costs not mentioned are specifically disallowed.

Certain overhead costs (such as the setup of an office in the particular province), the costs of terminating employees (which is part of the employment process), the cost of acquiring and licensing technology, capital taxes, technical or non-technical costs incurred within a reasonable time after startup, processing fees paid to third parties to process or refine oil or gas, environmental cleanup costs, fines, penalties, taxes and other costs might be allowed rather than disallowed.

d. *Royalty Tiers*

In the *Offshore Petroleum Royalty Regulations* and both the existing and draft east coast Canada offshore royalty agreements, the royalty rate fluctuates when certain threshold levels of rates of return on capital have been reached. Generic offshore royalty regulations fix these threshold levels and the rates of return. The owner of the non-renewable resource might be conservative in fixing the levels. Accordingly, in order to encourage the investment of the significant capital required to develop non-renewable offshore resources, the threshold levels will inevitably require some tinkering. That flexibility may not be built into generic offshore royalty regulations. It may be advantageous to tailor the levels and rates of return to the particular economic circumstances of a project. Royalty holidays and fixed gross royalty rates during specific periods, as well as two-way payouts, might also be achieved. An annual smoothing of costs might avoid the premature triggering of a payout of a royalty tier.

135. *Ibid.*, ss. 60(a) and 64.

136. *Ibid.*, s. 64(1)(p).

e. Uplift of Costs

In a net profits offshore royalty regime, costs are typically uplifted to provide the necessary economic result or, as a substitute, for the allowance of certain overhead costs. In a particular project, it might be more appropriate to have a different uplift on different costs. For instance, the uplift for operating costs might be 10 percent and the uplift for capital costs might be 1 percent. The uplift for certain costs such as insurance, research and development, netback costs, fuel gas and technical costs outside of the province might also be different from the standard 1 percent or 10 percent. Certain other costs in respect to benefits paid in the province, or salaries paid to employees residing in the province, might even attract a larger percentage uplift. A royalty agreement might also provide additional incentives to the developer of the non-renewable resource for the expenditure of certain funds which the government might consider more desirable or which it considers might provide greater overall benefit to that province, Canada or its people.

f. Investment Tax Credits

The *Income Tax Act*¹³⁷ provides an investment tax credit¹³⁸ to taxpayers who have incurred certain costs in respect to qualified property. The investment tax credit is a credit against tax otherwise payable by the taxpayer. Qualified property¹³⁹ is defined as follows:

“qualified property” of a taxpayer means property (other than an approved project property or a certified property) that is . . .

- (c) to be used by the taxpayer in Canada primarily for the purpose of . . .
- (iv) operating an oil or gas well or extracting petroleum or natural gas from a natural accumulation of petroleum or natural gas . . .
- (x) exploring or drilling for petroleum or natural gas

The specified percentage in respect of a qualified property acquired primarily for use in Newfoundland or Nova Scotia or for use in a prescribed offshore region is 10 percent. Investment tax credits are not provided for costs of the drilling of oil or gas wells in the Province of Alberta. For a taxpayer who is taxable, investment tax credits are extremely valuable. The *Offshore Petroleum Royalty Regulations* reduce

137. R.S.C. 1985 (5th Supp.), c. 1.

138. *Ibid.*, s. 127(5). The definition of investment tax credit reads: “investment tax credit” of a taxpayer at the end of a taxation year means the amount, if any, by which the total of (a) the total of all amounts each of which is the specified percentage of the capital cost to the taxpayer of certified property or qualified property acquired by the taxpayer in the year”

139. *Ibid.*, s. 127(9).

the costs for royalty purposes to the extent that the investment tax credits are received from Canada.¹⁴⁰ A royalty agreement might require part or none of such investment tax credits to be utilized to reduce costs.

g. Assessment Act (Nova Scotia)

Gas and oil, among other things, are “assessable property” under the *Assessment Act*.¹⁴¹ Assessable property is liable to taxation for all purposes for which municipal taxes and rates are levied.¹⁴² Forest property and other resources (not including oil and gas) have been exempted. Oil and gas is not exempt from taxation under s. 5 of the *Assessment Act*. As the Halifax Regional Municipality extends its jurisdiction into the offshore, it is arguable that the gas in a gathering line to shore might be subject to taxation under the *Assessment Act*. It might also be arguable that the gas and/or liquids in a gathering, transportation or sales line are subject to tax in the applicable municipality.

Property is assessed in the municipality in which it is located and in the state it is in on the day of forwarding the assessment roll to the clerk at its market value (being the amount which, in the opinion of the assessor, would be paid if it were sold on a date prescribed by the Director of Assessment in the open market by a willing seller to a willing buyer).¹⁴³ The current date prescribed by the Director of Assessment is January 1, 1999. That date is updated regularly. Accordingly, the value of the oil or gas in a reservoir or a gathering, transportation or sales line may be subject to taxation under the *Assessment Act*. The value is probably only the linepack in a gathering, transportation or sales line on the prescribed date. The value of the oil and gas in the reservoir is probably nil until it is captured. However, this amounts to double taxation on the oil and gas resource. A royalty is already payable to Nova Scotia and this, in effect, amounts to a second royalty payable to the municipalities. Where a royalty agreement is entered into, this matter can be dealt with by crediting any taxes on the oil and gas levied by the municipalities against royalties otherwise payable under the royalty agreement. Such a credit does not occur in the *Offshore Petroleum Royalty Regulations*. Alternatively, a companion Act exempting oil and gas from such double taxation could be enacted.

140. *Supra* note 121, ss. 45, 60(a)(iv) and 64(1)(f).

141. S.N.S. 1989, c. 23, s. 2(a)(iv).

142. *Ibid.*, s. 4.

143. *Ibid.*, ss. 30(1) and 42(1).

h. *The Revenue Act (Nova Scotia) and Gasoline Tax Act (Newfoundland)*

Nova Scotia imposes a 13+ cent per litre tax on gasoline used or consumed within the province.¹⁴⁴ The Governor in Council may make regulations exempting any consumer or purchaser from payment of the tax. The Health Services Tax imposed by Nova Scotia is a tax at the rate of 3 percent of the purchase price of electricity and 11 percent of the purchase price of tangible personal property, which exempts property (subject to some exceptions) used in the offshore area.¹⁴⁵ Remission or relief from the provisions of the gasoline tax or the Health Services Tax is not provided in the *Offshore Petroleum Royalty Regulations*. Section 25 of the *Revenue Act* provides a long list of exemptions from the *Health Services Tax*, including tangible personal property consumed or used in the production or processing of non-renewable resources. Subsection 27(2) provides that the Governor in Council may make regulations “to determine the extent and manner that exploration for, extraction of, or transformation or conversion of any non-renewable resource is production or processing.”

Newfoundland imposes a 16+ cent per litre tax on gasoline and 18 cent per litre tax on leaded gasoline acquired at a retail sale in the province.¹⁴⁶ Tax is also payable to the Government of Newfoundland and Labrador in the event that such gasoline is consumed or used prior to retail sale.¹⁴⁷ The Lieutenant-Governor in Council may make regulations exempting gasoline used for a purpose specified in the regulations or exempting a class of persons from the payment of tax.¹⁴⁸

Exemptions from the payment of tax or the remission thereof might be provided pursuant to the terms of a written agreement. Generic offshore royalty regulations may not grant such specific exemptions.

i. *Retail Sales Tax Act*

The *Retail Sales Tax Act* imposes a tax at the rate of 15 percent of the purchase price of tangible personal property (subject to certain exceptions).¹⁴⁹ Part II of that legislation provides certain exemptions and reduced rates of tax for the Hibernia Development Project.¹⁵⁰ The project tax rate under the *Retail Sales Tax Act* is 0 percent in the case of an item

144. *Revenue Act*, S.N.S. 1995-96, c. 17, s. 6.

145. *Ibid.*, s. 14 and 15(1).

146. *Gasoline Tax Act*, R.S.N. 1990, c. G-1, s. 3.

147. *Ibid.*, s. 8.

148. *Ibid.*, ss. 48.(1), (h) and (j).

149. R.S.N. 1990, c. R-15, s. 3.

150. *Ibid.*, s. 84.

which is consumed or used on a project capital program, and 4 percent in the case of an eligible item which is consumed or used other than for a project capital program.¹⁵¹ Generic offshore royalty regulations may not grant exemptions or similar reductions.

j. *Capital Taxes*

The royalty payment should be the entire fiscal take for the project by the government from the developer of the non-renewable resource. Capital taxes are another method used by governments to tax the capital employed by a taxpayer. In offshore non-renewable resource projects, billions of dollars of capital can be spent in constructing and operating a project. If a tax were to be imposed on that project capital, it might be considered to be an indirect method of extracting an additional royalty on the non-renewable resource.

Capital taxes have been imposed under the federal *Income Tax Act* on the taxable capital of financial institutions and large corporations.¹⁵² In Nova Scotia, a capital tax has been imposed on the taxable paid-up capital of certain financial corporations.¹⁵³ In Newfoundland, a capital tax has been levied on the taxable paid-up capital of financial corporations.¹⁵⁴ The *Offshore Petroleum Royalty Regulations* do not provide a credit for capital taxes paid to either Canada or Nova Scotia. Furthermore, such capital taxes are not deductible in calculating the project costs.¹⁵⁵ A royalty agreement may provide for a credit against royalty payable in the amount of such capital taxes or might consider such capital taxes as an allowed cost in calculating the net profits offshore royalty.

k. *Low Product Prices*

The reduction of the basic/gross royalty or the incremental/net profits royalty to take into account low commodity prices might be a term negotiated in a royalty agreement. The *Offshore Petroleum Royalty Regulations* do not include royalty protection in the event of low commodity prices.

l. *Processing Revenues*

After the resources are fully depleted, the developer may continue to own and operate processing facilities, gathering lines and other equipment which was deducted in the calculation of the net profits royalty. As no

151 *Ibid.*, s. 83(1)(w).

152 *Supra* note 137, s. 190.1, for financial institutions tax, and s. 181.1 for large corporations tax.

153. *Corporation Capital Tax Act*, R.S.N.S. 1989, c. 99.

154. *Financial Corporations Capital Tax Act*, R.S.N. 1990, c. F-9.

155. *Supra* note 121, ss. 60(a)(vi) and 64(1)(j).

production is occurring, the royalty can no longer be based on the molecules produced from the reservoir. In a royalty agreement situation, the extent to which subsequent processing revenues are shared with the owner of the resource, if any, is a negotiated item. In the *Offshore Petroleum Royalty Regulations*, the processing revenues continue to be paid to the owner of the resource.¹⁵⁶

2. Commercial Terms

a. Advance Ruling

A net profits offshore royalty regime results in a very complicated accounting exercise. A mechanism to provide for advance rulings prior to incurring an expenditure would be very useful. Such a mechanism would provide greater certainty to the developer of the non-renewable resource prior to its incurring an expense and may avoid unnecessary disputes at a later date. As payout of the royalty tiers may take years or decades, it is desirable to provide greater certainty at an earlier stage in the development of the project. The *Offshore Petroleum Royalty Regulations* provide a mechanism for advance rulings.¹⁵⁷

b. Dispute Resolution Mechanism

In generic offshore royalty regulations, the Lieutenant-Governor in Council or Governor in Council may not provide an adequate dispute resolution mechanism. There is an argument that this unduly fetters the discretion of the minister and is *ultra vires*. In the *Offshore Petroleum Royalty Regulations*,¹⁵⁸ a partial dispute resolution method was adopted. A committee or board may be established by the minister to whom a dispute would be referred. The dispute would be considered by that committee or board, then a recommendation made to the minister. Although the minister would not be bound by that recommendation, the minister would be bound to duly consider the recommendation and then make his decision.

A net profits offshore royalty regime is a very complicated and complex arrangement. A process by which a dispute could be settled by binding arbitration is obviously preferable. A royalty agreement might provide for such binding arbitration to resolve disputes.

156. *Ibid.*, ss. 5(f), 18(1)(f), 21(b), 44(8)(d), 44(8)(e) and 58(r).

157. *Ibid.*, s. 71.

158. *Ibid.*, s. 73.

c. *Ring Fence*

The scope of a non-renewable resource project under generic offshore royalty regulations is, by its very nature, somewhat limited. This would typically include the producing wells and, perhaps, a processing facility. The inclusion in the project of fractionation facilities, gathering lines, sales lines, tankers, docks and other facilities is probably not possible without the inclusion of the same in a royalty agreement. A combination of fields would also be advantageous so that the real rate of return for the developer might be accounted for.

d. *Fuel Gas*

To the extent that gas is utilized in operations, its virtue is not included in the determination of the royalty. Such gas is generally considered not to have exited the ring fence and is not beyond the royalty meter for royalty purposes. However, where such gas is used in facilities which are outside the ring fence, a special arrangement might be agreed to in a royalty agreement in respect to the payment or non-payment of royalties in respect to such gas.

e. *Duplication of Royalties*

As referenced in Part IV, notwithstanding the enactments of the *Accord Acts*, the *Provincial Accord Acts*, the *Royalty Acts* and numerous regulations, there is a great deal of uncertainty regarding the delegation of powers and the ownership and administration of offshore natural resources. The constitutional and legal uncertainty provide an opportunity for politicians and the press to make royalty issues into election issues. No project or industry can be expected to create enough jobs or eliminate unemployment for any government. After significant capital has been spent, the developer of the resource might become a target for the politicians of the day. A generic offshore royalty regime leaves the developer of the resource with a significant risk that the generic offshore royalty regime could change subsequent to or during the expenditure of its capital and prior to or during the receipt of its return on capital.

The execution of a royalty agreement can reduce some of the risks and consequences of political change. Representations and warranties, as well as indemnification or credits in respect to the imposition of additional taxes or royalties by other levels of government, including municipalities and the Government of Canada, if properly structured, can provide the developer with appropriate remedies in the event that the royalty agreement is breached by that government.

Contracts between the private sector and a government will be honoured by the courts. In the Ontario decision regarding the cancellation of

contracts for Terminal 1 and Terminal 2 at the Lester B. Pearson International Airport,¹⁵⁹ Borins J. easily concluded that he was satisfied that the government had committed a breach of the airport contracts. As there was no genuine issue for trial, Borins J. granted the Summary Judgment Application of the plaintiff. In granting such judgment, reliance was placed on the decision in *Munro v. Canada*¹⁶⁰ and the provisions of the *Proceedings Against the Crown Act* (Ontario). In rendering his decision, Borins J. held:

At common law, the Crown has always been able to bring proceedings to enforce contracts made on its behalf. However, the Crown was immune from suit by a subject to enforce a contract. The only way that such an action could be brought against the Crown was to obtain a fiat from the Crown, allowing the subject to file a petition of right. The granting of a fiat, although a matter of discretion, was generally consented to as a matter of course: see Paul Lordon, *Crown Law* (Toronto: Butterworths, 1991), p. 319, s.21(1) is the modern replacement for the petition of right, creating a right, which does not otherwise exist, to implead the Crown in a provincial superior court.¹⁶¹

In Newfoundland¹⁶² and Nova Scotia,¹⁶³ s. 6 of the *Proceedings Against the Crown Act* provides that “[t]he law relating to indemnity and contribution is enforceable by and against the Crown in respect of a liability to which it is subject, as if the Crown were a person of full age and capacity.” Furthermore, the Nova Scotia statute¹⁶⁴ reads, “subject to this Act, a person who has a claim against the Crown may enforce it as of right by proceedings against the Crown in accordance with this Act in all cases in which . . . (b) the claim arises out of a contract entered into by or on behalf of the Crown . . . ”

In the Newfoundland statute¹⁶⁵ “a claim against the Crown that, but for this Act, might be enforced by petition of right, subject to the approval of the Lieutenant-Governor, may be enforced as a right by proceedings against the Crown under this Act, without the approval of the Lieutenant-Governor.” Injunctive relief and specific performance are not available against the Crown.¹⁶⁶

159. *T1 T2 Limited Partnership v. Canada (A.G.)* (1995), 23 O.R. (3d) 81 (Gen. Div.).

160. *Munro v. Canada* (1992), 11 O.R. (3d)1.

161. *Ibid.* at 10-11.

162. *Proceedings Against the Crown Act*, R.S.N. 1990, c. P-26.

163. *Proceedings Against the Crown Act*, R.S.N.S. 1989, c. 360.

164. *Ibid.*, s. 4(b).

165. *Supra* note 162, s. 4(1).

166. *Ibid.*, s. 15(1); *supra* note 163, s. 16(2).

f. *Gross Negligence*

In certain instances, costs resulting from the gross negligence of an operator or interest holder may be disallowed. Where a royalty agreement is entered into, the disallowance of such costs might be more restrictive and the events which constitute such gross negligence might be tailored to the structure of the particular project.

g. *Security Arrangements*

The *Petroleum and Natural Gas Act* provides, in certain provisions which have not yet been proclaimed, for the interest holder to provide certain proof of financial responsibility and for the establishment of a compensation fund.¹⁶⁷ A royalty agreement might provide that such security agreements do not apply to the participants in a project. Furthermore, a royalty agreement might provide the mechanics of dealing with a situation where one or more interest holders is in default in the payment of royalty. Ongoing operating and capital costs might continue to be paid. The mechanics might be dependent upon established credit ratings for the participants. Releases of interest holders from subsequent royalty payments upon assignments to assignees with acceptable credit ratings might also be provided for.

h. *Dispositions*

In a net profits offshore royalty regime, dispositions of the assets which are included in the allowed costs are typically recovered by way of reduction of further costs or perhaps as a revenue inclusion. In situations where the disposition of a facility or piece of equipment is, in reality, a financing transaction and capacity to that facility or equipment is retained by the assignor, a royalty agreement might ignore such transaction for royalty consequences. In the *Offshore Petroleum Royalty Regulations*, the treatment of such a disposition is entirely within the discretion of the minister.¹⁶⁸

The disposition of field assets might be treated as a reduction of subsequent costs rather than a revenue inclusion under a royalty agreement.

i. *Confidentiality Agreements*

A royalty agreement might require that the minister obtain executed confidentiality agreements with persons it retains as agents to assist in the administration of the royalty. The marketing arrangements of a producer are particularly sensitive to unwanted disclosure. A direct contractual link with such agent might prevent disclosure of confidential information.

167. *Supra* note 9, ss. 10-19.

168. *Supra* note 121, s. 53.

j. *Taking in Kind*

Royalty agreements might tailor the taking-in-kind provisions to the particular project. The producer might structure the taking-in-kind provisions so that it is able to honour its marketing and transportation arrangements, is not left with non-deductible firm service charges for stranded capacity and is able to enter into marketing arrangements which obtain the highest possible price for that producer.

k. *Communication*

The electronic transfer of funds to specific accounts might be provided for. This is very difficult when the province, the Government of Canada and the CNOBP or CNSOPB are all involved in the payment. In addition, communication by way of e-mail may be provided for in a royalty agreement.

l. *Environmental Assessment Act (Newfoundland)*

The *Environmental Assessment Act* provides that the minister, with the approval of the Lieutenant-Governor in Council, may by order

exempt an undertaking or a proponent of an undertaking from the application of this Act or the regulations or a matter provided for in this Act, subject to the terms and conditions that the minister may, in his or her discretion, impose;¹⁶⁹

The Terra Nova Development Project has been exempted from the former *Environmental Assessment Act* based on a memorandum of understanding among the relevant departments and agencies of the federal and provincial governments and the CNOBP.¹⁷⁰

m. *Crown Royalties Act (Newfoundland)*

The *Crown Royalties Act* adds certain terms to legislative acts, agreements, leases and licences:

(1) . . . it shall be considered to be a term of the Act, agreement, grant, lease, licence, concession or other arrangement *unless otherwise expressly stated* that the *mineral*, timber, power or other product or thing *shall be disposed of at or about the current commercial market value*.

(2) The sales shall be made and the operations carried on upon ordinary and reasonable commercial terms and conditions so as to give to the Crown the royalty that is fair under the circumstances.

(3) Where the royalty is upon net profits or returns or values, *the charges deducted* from the gross in order to arrive at the net profits shall *be fair and reasonable and according to commercial practice*.¹⁷¹

169. *Environmental Assessment Act, 2000*, S.N. 2000 c. E-14.1, s. 28(a).

170. *Terra Nova Development Project Exemption Order*, Nfld. Reg. 37/96, ss. 2 and 4.

171. R.S.N. 1990 c. C-43, ss. 2(1), (2) and (3) [emphasis added].

Pursuant to the *Crown Royalties Act* the royalty payable is decided by arbitration.¹⁷² It is not indicated whether the arbitration is held before or after wells are drilled and capital expended. This statute does not apply to the Hibernia Development Royalty Agreement.¹⁷³

n. *Customs and Excise Offshore Application Act (Canada)*

The *Customs and Excise Offshore Application Act* provides:

3(1) Subject to sections 5 to 8, federal customs laws apply in respect of goods on their arrival within the limits of the continental shelf of Canada for use as designated goods as if those goods were for use or consumption in Canada, and for those purposes references in federal customs laws to importation of goods into Canada shall be deemed to include bringing goods within the limits of the continental shelf of Canada for use as designated goods.¹⁷⁴

However, s. 3

does not apply in respect of goods for use as designated goods that are brought within the limits of the continental shelf after June 30, 1983 pursuant to a written contract entered into prior to January 6, 1983, when the goods are used or consumed within the limits of the continental shelf of Canada.¹⁷⁵

Designated goods are defined as

(a) artificial islands, ships, vessels, installations, structures or apparatus, including drilling rigs, drilling ships, production platforms, storage vessels, storage tanks, docks, caissons and pipelines, permanently or temporarily attached to or resting on the continental shelf of Canada for the exploration, development, production or transportation of the mineral or other non-living natural resources thereof,

(b) ships, vessels, equipment, structures, apparatus or conveyances used for the construction, erection or servicing of any artificial island, ship, vessel, installation, structure or apparatus referred to in paragraph (a) or for the transportation of goods between any such thing and a point in Canada or between any such things, and

(c) goods for use or consumption on any artificial island, ship, vessel, installation, structure, apparatus, equipment or conveyance referred to in paragraph (a) or b);¹⁷⁶

Unless fiscal negotiations (such as those involving the Hibernia Development Project) occur with the Government of Canada, relief from customs and excise taxes is unlikely. In any event, it cannot be part of a provincial generic royalty regime.

172. *Ibid.*, s. 4.

173. *Ibid.*, s. 9.

174. S.C. 1984 c. 17.

175. *Ibid.*, s. 3(1).

176. *Ibid.*, s. 2(1).

o. Other

Other matters which might also be dealt with in a royalty agreement include a limitation period on reassessments of royalty, reduced penalties on default, mutual interest provisions on default and on refunds, several versus joint and several liability for royalty payments by interest holders, and limitations on the rights to cancel production licences in the event of default by some but not all the interest holders. The foregoing is but a sample of the issues which might be handled more satisfactorily in a royalty agreement.

VIII. *Parties to the Royalty Agreement*

1. *Province*

In the case of Nova Scotia, the Royalty Collection and Administration Agreement has been entered into with Canada and the CNSOPB. Accordingly, assuming that the Royalty Collection and Administration Agreement is effective at law, Nova Scotia would be a proper party to a royalty agreement regarding the Nova Scotia offshore area. However, if the Royalty Collection and Administration Agreement was not effective at law, Nova Scotia would still be a party to a royalty agreement, as the various fiscal matters involving the province would need to be dealt with.

The *Newfoundland Accord Act*¹⁷⁷ provides for the submission to the CNOBP of a “Canada-Newfoundland benefits plan.” The Canada-Newfoundland benefits plan is defined as

a plan for the employment of Canadians and, in particular, members of the labour force of the Province and, subject to paragraph (3) (d), for providing manufacturers, consultants, contractors and service companies in the Province and other parts of Canada with a full and fair opportunity to participate on a competitive basis in the supply of goods and services used in any proposed work or activity referred to in the benefits plan.¹⁷⁸

The *Nova Scotia Accord Act*¹⁷⁹ likewise provides for a Canada-Nova Scotia benefits plan which is similarly defined. The *Newfoundland Accord Act*¹⁸⁰ provides for the CNOBP to enter into memoranda of understanding with the Government of Canada and the Government of the Province in relation to:

- (a) environmental regulation;
- (b) emergency measures;
- (c) coast guard and other marine regulation;

¹⁷⁷ *Supra* note 5, s. 45(2).

¹⁷⁸ *Ibid.*, s. 45(1)

¹⁷⁹ *Supra* note 14, s. 45.

¹⁸⁰ *Supra* note 5, s. 46.

(d) employment and industrial benefits for Canadians in general and the people of the Province in particular and the review and evaluation procedures to be followed by both governments and the Board in relation to such benefits;

(e) occupational health and safety; and

(f) such other matters as are appropriate.

The *Nova Scotia Accord Act* likewise provides for memoranda of understanding with the CNSOPB.¹⁸¹ The provisions use language similar to the *Newfoundland Accord Act*, except that a memorandum in relation to a Nova Scotia trunkline within the meaning of s. 40 is also required.

The requirement for benefits plans and memoranda of understanding necessitates that the province be actively involved in any development of offshore non-renewable resources. The issues regarding benefits will also invariably involve further agreements between the particular province and the developer of the non-renewable resources. Furthermore, as the resource developer is at the table negotiating the benefits package, it may as well be at the table negotiating a royalty agreement which is tailored to its particular project, even if generic offshore royalty regulations have been issued.

2. *Government of Canada*

The issue of whether Canada should be a party to the royalty agreement is more a political question than a legal one. Legally, the Government of Canada has principal jurisdiction over the non-renewable resources in the offshore area and should be a party to any valid and binding royalty agreement. The issues regarding administrative inter-delegation, referential incorporation and legislative inter-delegation discussed in Part IV of this article all create significant risk to a producer if Canada is not a party to the royalty agreement.

Newfoundland has attempted to satisfy some of these concerns by the introduction of the 1 cent per barrel statutory royalty and by providing that the royalty agreement is: (a) not executed pursuant to the complex accord legislation; and (b) is not executed pursuant to its own *Petroleum and Natural Gas Act*. Does Newfoundland intend to pass a separate regulation for every project? The stopgap measures utilized for the Hibernia Development Project might be used for the Terra Nova Development Project. Will they also be used for the White Rose Project, the Hebron Project and subsequent projects?

The situation regarding the Nova Scotia offshore is equally uncertain and unacceptable. The Government of Canada has for all practical purposes abrogated absolutely all authority and responsibility over the

181 *Supra* note 14, s. 46.

Nova Scotia offshore. The commercial fixes in the Sable Offshore Royalty Agreements are not available to developers of non-renewable resources who rely on the *Offshore Petroleum Royalty Regulations* to prescribe the royalty provisions regarding its production.

IX. Political Risk

Newfoundland and Nova Scotia have provided that the Lieutenant-Governor in Council and Governor in Council, respectively, are authorized to enact regulations respecting royalties. The enactment of regulations is not performed in a public forum. Regulations are prepared by bureaucrats and passed by cabinets. All of this occurs behind closed doors in a party-based political system. A generic offshore royalty regime provides no certainty for a developer of a non-renewable resource in the offshore.

The enactment of statutes, such as the *Petroleum and Natural Gas Act* and *Offshore Petroleum Royalty Act*, is also a political process, but it at least involves the reading of the bill publicly in the legislature. In that sense, a royalty and fiscal regime is always one step away from being an election issue. A government has the absolute right to enact legislation within its jurisdiction and to terminate or disavow any contract.¹⁸² However, where a royalty agreement is executed, a government would be liable in damages for breaching such agreement. No injunctive relief or specific performance would be possible, but damages could be obtained. The breach of a contract may have some political consequences, although the political ramifications in the Pearson Airport situation appear to have been minimal.

In Alberta, there is a mature oil and gas industry. The Government of Alberta and the industry have worked together for more than forty years to build a resource industry. A level of trust exists between Alberta and the oil and gas industry. Benefits plans are not the central focus of resource development in Alberta. There is no HST in Alberta, and provincial, corporate and individual income tax rates are significantly below those in Newfoundland and Nova Scotia.

Alberta has thirty years of experience in the production of oil sands resources. Suncor has been producing oil sands reserves since 1967 and Syncrude since 1978. The development of the oil sands is capital intensive and price sensitive, but involves little or no reservoir risk. Major oil and gas developments, such as the oil sands projects, are not used by Alberta politicians as a political target to entice the electorate. Alberta implemented its generic oil sands royalty regime with the enactment of

182. See *supra* note 159.

the *Alberta Oil Sands Royalty Regulations, 1997*.¹⁸³ The oil and gas industry has responded to the *Alberta Oil Sands Royalty Regulations, 1997*, and \$19 billion of expansions to existing operations and new projects have been announced or are already in the design phase.

It is the author's view that the level of trust does not exist to the same extent between the Government of Newfoundland and Labrador, the Government of Nova Scotia and the oil and gas industry in the east coast offshore areas. Large billion-dollar resource projects are used as a target, rather than a drawing card, by the press and politicians. Benefits plans drive the project approvals.

The Cohasset/Panuke \$1.3 billion project is now shut in after only seven years of production. The \$8 billion Hibernia Development Project commenced production in November 1997, and the \$2.6 billion Sable Offshore Energy Project commenced production in December 1999. The \$2.2 billion Terra Nova Development Project is proceeding. However, the Hibernia field was discovered in 1981, the six Sable fields were discovered during the late 60s, the 70s and the early 80s. The Terra Nova field was discovered in 1984, the Hebron field was discovered in 1981 and the White Rose field was discovered in 1988. Producing each of these discoveries will involve significant reservoir risk. Approximately \$10 billion was spent in the period from 1970 through 1988 on the exploratory and delineation drilling of more than 250 wells offshore the east coast of Canada. Exploratory drilling in the east coast peaked in the period 1979 through 1988.

The delay in creating a scheme for generic royalties by the Province of Newfoundland is a hindrance to the development of the offshore resources. The uncertainties created by the *Accord Acts*, the *Provincial Accord Acts*, the *Royalty Acts*, the numerous regulations and the abrogation by the Government of Canada are not good for business and need to be fixed. The legal machinations required need to be eliminated, notwithstanding the political sensitivities. If the foregoing actions are taken, industry will respond as shown by its recent commitments of \$19 billion of capital expenditures in the Alberta oil sands projects.

Conclusion

The experience in the offshore with respect to costs, revenues, marketing, transportation and the like is limited to the Cohasset/Panuke, Hibernia and Sable development projects. Until there is greater experience with projects in the offshore, generic offshore royalty regulations will inevitably involve a bit of trial and error. Both industry and government are

183. Alta. Reg. 185/97.

developing their knowledge with respect to such projects and, as their experience level grows, so will the level of comfort.

The review of constitutional case law, federal-provincial agreements, two lengthy federal statutes, two lengthy provincial “reciprocal” statutes, several provincial statutes and regulations relating to royalties, and numerous provincial statutes and regulations exempting offshore energy projects from various fiscal and commercial provisions of provincial statutes and regulations raises more questions than it answers.

An interest holder of a lease in the offshore area is confronted with the unfortunate circumstance that the Government of Canada has abandoned the legislative and regulatory field regarding the offshore royalty. As it is not involved in the negotiation and execution of royalty agreements, the current constitutional, legislative and regulatory solutions are problematic. As a result, the draftsmen of the east coast offshore royalty agreements have created agreements which either are not entered into pursuant to the referenced statutes and regulations, or depend on other legal fiction and wizardry to provide the interest holder with some semblance of certainty surrounding the fiscal and commercial terms of the royalty. When will proper legislation be enacted to fix the problems? Will the Government of Canada take its rightful place as a party to the royalty agreement? Is the political situation so sensitive that industry must continue entering into agreements which are in many respects fictional?

Generic offshore royalty regulations are important in setting out the fiscal and commercial terms of the royalty. The template of the *Offshore Petroleum Royalty Regulations* introduced by Nova Scotia is a productive first step. Such regulations are not tailored to a particular offshore energy project and are weighted against the developer of the non-renewable resource. In light of the uncertainty created by the referential incorporation by Canada of provincial statutes and regulations and the delegation of its powers, an interest holder relying on generic offshore royalty regulations takes on an unacceptable legal risk, as well as commercial and fiscal terms which may be less than satisfactory.

Considering the foregoing, the conclusion reached is that, in all instances, an interest holder in the offshore area will require a written royalty agreement with the provincial government.