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Fallow Fields Initiatives and Canada's East Coast Offshore: Policy and Legal Considerations

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The author examines various approaches adopted by government to balance the state's interest in promoting the timely and efficient exploration and development of oil and gas resources under state jurisdiction and industry's need for legal regimes providing security of tenure and other conditions necessary for commercial success. In particular, the paper considers fallow field initiatives adopted by the United Kingdom in respect of the North Sea and their possible application to government's management of oil and gas resources in the Canadian east coast offshore areas, addressing applicable policy considerations, the legislative history of the statutory frameworks in place, and related jurisprudence.

L'auteur examine diverses méthodes adoptées par le gouvernement pour équilibrer l'intérêt de l'État - promouvoir l'exploration et l'exploitation efficientes, en temps opportun, des ressources en hydrocarbures qui sont de sa compétence - et le besoin qu'a l'industrie de régimes législatifs lui offrant la sécurité de tenure et d'autres conditions essentielles à sa réussite commerciale. En particulier, l'article examine les projets dits de « champs en jachère » adoptés par le Royaume-Uni pour la Mer du Nord et leur application possible à la gestion, par le gouvernement, des ressources en hydrocarbures de la région extracôtière de l'est du Canada; il aborde les considérations politiques applicables, le contexte historique du cadre législatif en place et la jurisprudence connexe.

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Introduction

Governments with varying degrees of urgency are concerned with the pace of development of oil and gas resources under their jurisdiction.[1] This is to be expected. Governments, in their capacity both as owners of oil and gas resources and regulators of oil and gas operations, have a responsibility to ensure that such resources are developed to maximize revenue and other benefits to be derived from these resources. Hence, governments attempt to devise fiscal and tenure systems to meet these governmental objectives while not discouraging investment from the private sector. This is no easy task and is rarely achieved to the satisfaction of all. Oil companies assist in the attainment of government objectives by providing technical and commercial expertise and capital, and by assuming most, but not all, of the risk. That being said, oil companies report to shareholders, not electorates, and a divergence of interest is inevitable. This paper considers Canada's experience regarding fallow fields issues on its east coast continental shelf

1. A recent and particularly relevant example of this is the policy statement issued by the Government of Newfoundland and Labrador on 11 September 2007 entitled "Focussing Our Energy, Newfoundland and Labrador Energy Plan" where the Government specifically addresses fallow fields issues relating to the Newfoundland offshore. A copy of this document can be found on the Government's website at <www.gov.nl.ca/energyplan/EnergyReport.pdf>.

(CCS). The history of the current CCS tenure system is reviewed as are the policy and legal issues associated with the existing legislation and other options available to governments to spur development. The United Kingdom's experience with these issues regarding its continental shelf (UKCS) is also reviewed to provide further insights.

I. *The fallow field issue*

Use of the term "fallow field" may be unique to the UKCS, but the underlying issues are of concern to all jurisdictions. What are the fallow field issues and what is at stake? Simply put, governments make acreage available to oil companies for exploration with the hope that oil and gas discoveries will be made and development will occur with its attendant benefits including revenue (by way of taxes, royalties, rentals and bonuses, or combinations thereof), increased employment, industrial activity and technology transfer. In exchange, oil companies assume certain risks and obligations to explore and develop acreage in the hope of making a profit, increasing shareholder value, and realizing target rates of return. It is a bargain between government and industry. To sweeten the bargain, governments use a variety of incentives to attract industry investment. These include favourable tax and royalty rates and attractive licence terms. To balance the equation, there are obligations, such as work and expenditure commitments, restrictions on length of tenure, relinquishment of acreage, and termination of licences in the absence of performance and, ultimately exploration success. The details of the bargain are found in the governing legislation and the terms and conditions of the licences granted. This paper focuses on one aspect of the bargain, the tenure regime as an instrument of government policy. It explores the question of how long exclusive exploration and development rights should be held without positive results, or at least some minimal level of ongoing activity. It discusses how the challenge of the fallow field issue has been addressed in Canada and how it might be addressed in the future.

II. *A brief survey of tenure systems*

It has been said that there are more petroleum fiscal systems in the world than there are countries.[2] The same can be said of tenure systems. Fiscal systems and tenure systems are different aspects, ideally complementary, of governmental attempts to establish successful oil and gas regimes. As background, this paper examines some tenure based approaches to fallow

2. D. Johnston, *International Petroleum Fiscal Systems and Production Sharing Contracts* (Tulsa: PennWell, 1994) at 5. This work provides an excellent analysis of fiscal issues and their relation to licence terms and conditions in numerous regimes throughout the world.

field issues in a number of jurisdictions to set the stage for the detailed analysis of the CCS and UKCS fallow initiatives that follows.

1. *Internationally*

Most of the oil and gas reserves in the world including the Middle East, Africa, China, South America, Indonesia and Russia are governed by one form or other of a production sharing contract regime.[3] Typically, these regimes provide for a relatively short exploration period combined with work or expenditure commitments and land relinquishment at specified intervals. At the end of the exploration period, the onus is on the oil company to demonstrate that a commercial discovery has been made, in which case there follows a longer production period during which the oil company is entitled to exploit the agreed discovery area for the production of petroleum. If there is no commercial discovery at the end of the exploration period, all acreage reverts to the state. At the end of the production period, not only all acreage but, in many cases, all production and related facilities revert to the state as well. The rule is work it or lose it.

2. *Australia*

Australia has a tenure system which is in many respects similar to that applicable to the CCS. Offshore acreage seaward of the three-mile territorial sea is under the jurisdiction of the federal government of Australia (Commonwealth), while the landward balance of offshore acreage is under the jurisdiction of the adjacent state. For acreage under federal jurisdiction, the governing legislation is the *Petroleum (Submerged Lands) Act 1967*.[4] The legislation is administered jointly by the Commonwealth and the applicable coastal state, which is similar in certain respects to the joint federal-provincial resource management regime established by the *Accord Acts*.[5] The Australian regime was designed to address jurisdictional disputes between the Commonwealth and the states. It has served as a model for the Canadian offshore legislation. The Australian regime has a three-tiered tenure system, not unlike the one applicable to the CCS, but with some important differences. The available oil and gas titles are the exploration permit, the retention lease and the production licence.

The exploration permit (comparable to the CCS exploration licence) is granted for six years. During the first three years, the licensee is obligated

3. *Ibid.* In particular, see Appendix A: Sample Fiscal Systems at 207 ff. for a summary of fiscal and licence tenure terms of numerous jurisdictions internationally.
4. (Cth.), as amended.
5. *Infra* note 13.

to carry out a guaranteed work program, failing which the permit is cancelled. During the second three-year period of the exploration permit term, work is guaranteed on a year-to-year basis only. The exploration permit is renewable for two additional five-year terms. There is a fifty per cent relinquishment requirement in respect of outstanding acreage at each renewal.

If a potentially commercial discovery is made, the permittee may apply for a retention lease. The discovery need not be commercially viable, but simply indicate a reasonable chance of becoming commercially viable within fifteen years. The retention lease is renewable for five-year periods. At each stage, the onus is on the permittee to meet this hurdle. The retention lease is the Australian equivalent of the significant discovery licence available for acreage in the CCS. Like the CCS significant discovery licence, it offers a degree of long-term tenure but it is not indefinite and the bar for obtaining the grant of such a lease is higher, putting the onus on the permittee to establish that there is a reasonable chance that the discovery might become commercial in the future.

If a commercial discovery is made during the term of the exploration permit, the permittee may within two years apply for a production licence. The term of a production licence is for the duration of commercial production plus five years. As a condition of the granting of the production licence, the permittee must provide details of its development proposal, not unlike the development plan contemplated by the *Accord Acts*. Further details of the Australian regime can be found on the Australian Department of Innovation, Industry, Science and Research website.[6]

3. *Alberta*

In Alberta, oil and gas tenure is governed by the *Mines and Minerals Act*.[7] Typically, petroleum and natural gas leases are issued for a primary term of five years. Pursuant to section 82(1) of that Act, leases may be continued beyond their primary term if continuation thereof is approved by the Minister under the *Petroleum and Natural Gas Tenure Regulations*.[8] Under the regulations, a lease will be continued if there is a producing well or a well capable of production in paying quantity. There is little jurisprudence considering these legislative provisions. The Alberta Court of Appeal in *R. v. Industrial Coal and Minerals*[9] considered the question of lease continuation under the *Mines and Minerals Act*. The case is

6. <http://www.innovation.gov.au>.
7. R.S.A. 2000, c. M-17.
8. Alta. Reg. 263/97.
9. [1979] 5 W.W.R. 102 (Alta. C.A.).

interesting because it exhibits a great deal of curial deference. The question was whether the well in question was capable of production of petroleum or natural gas in paying quantity so as to qualify the lease for continuation beyond its primary term. In the words of Moir J.A.:

> That was the minister's decision–it is final and is not to be reviewed as to its validity in this type of proceeding. The minister had the power and the duty to decide. He did so and that is the end of the matter. We think that this decision was eminently reasonable.[10]

There was no discussion of what constitutes paying quantity and not much appetite exhibited for judicial review of ministerial decisions regarding continuation of leases. Indeed, there is little Canadian jurisprudence generally on what constitutes "paying quantity." Whatever case law there is has been reviewed by R. H. Bartlett[11] along with relevant United States authorities. The jurisprudence deals with the construction of the granting, habendum and shut-in clauses in freehold oil and gas leases. Owners of freehold oil and gas estates share governments' desire to maximise economic returns but, of course, cannot be expected to share governments' concern for broader policy issues. This line of jurisprudence may be of interest in the construction of language used in the Alberta legislation. It is not, however, particularly helpful in respect of the fallow field issues confronting the CCS. Suffice to say, generally fallow field issues have not been a particular concern in Alberta apart from deep rights reversion which as an issue was confronted and dealt with in the 1980s.[12]

III. *The Canadian offshore experience*

Oil and gas tenure and operations on the CCS are governed by legislation implementing the *Atlantic Accord* entered into by the Government of Canada and the Government of Newfoundland and Labrador on 11 February 1985 and the *Canada-Nova Scotia Offshore Petroleum Resources Accord* entered into by the Government of Canada and the Government of Nova

10. *Ibid.* at 102.

11. R. H. Bartlett, "The Effect of Low Oil and Gas Prices on Freehold Oil and Gas Leases: A Problem of Interpretation" (1991) 29 Alta. L. Rev. 1.

12. Alberta petroleum and natural gas leases are relatively small in areal extent compared to licences granted in respect of acreage in respect of the CCS but typically grant rights from surface to basement. The fallow issue here was the failure to explore and develop deeper rights. The *Mines and Minerals Act* was amended to provide for reversion to the Crown of rights stratigraphically below the deepest producing formation.

Scotia on 26 August 1986.[13] The provisions of the implementing legislation of the federal government and the two provinces insofar as they relate to the fallow field issues discussed in this paper are essentially identical.

The *Accord Acts* implement a political settlement of the federal-provincial constitutional dispute concerning jurisdiction over offshore oil and gas resources. The settlement is a joint federal-provincial resource management scheme administered by the Canada-Newfoundland and Labrador Offshore Petroleum Board (CNLOPB) and the Canada-Nova Scotia Offshore Petroleum Board (CNSOPB) for the Newfoundland offshore area and the Nova Scotia offshore area, respectively.[14] The *Accord Acts* establish the Boards,[15] provide for a certain degree of political oversight over fundamental decisions of the Boards and contemplate the federal and provincial governments acting in tandem where legislation must be amended and regulations promulgated. The core oil and gas aspects of the *Accord Acts* are modelled on the *Canada Petroleum Resources Act*[16] and the *Canada Oil and Gas Operations Act*.[17] Insofar as fallow field issues are concerned, the legislation governing the CCS and those lands under exclusive federal jurisdiction are substantively the same. As such, to understand the current CCS land tenure system and related fallow field issues, one must consider the history of Canadian federal oil and gas legislation and policy.

It was not until the proclamation of the *Canada Oil and Gas Act*[18] on 5 March 1982, that the oil and gas licensing and tenure system for Canada's north and offshore areas was first statutorily entrenched. Prior to that time, rights were granted pursuant to regulations promulgated from time to time under federal statutes, initially under the *Dominion Lands Act*[19] and

13. *Canada-Newfoundland Atlantic Accord Implementation Act*, S.C. 1987, c. 3 [*Federal Accord Act*]; *Canada-Newfoundland and Labrador Atlantic Accord Implementation Newfoundland and Labrador Act*, R.S.N. 1990, c. C-2; *Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act*, S.C. 1988, c. 28; and *Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation (Nova Scotia) Act*, S.N.S. 1987, c. 3 [collectively, *Accord Acts*]. For convenience, where section references to the legislation are made, they are to the *Federal Accord Act*.

14. See *Reference Re Offshore Mineral Rights of British Columbia*, [1967] S.C.R. 792; *Reference Re the Seabed and Subsoil of the Continental Shelf Offshore Newfoundland*, [1984] 1 S.C.R. 86; and *Canada (A.G.) v. British Columbia (A.G)*, [1984] 4 W.W. R. 289 (S.C.C.). In each of these cases, the matter in dispute was which level of government has jurisdiction over offshore resources and in each case, subject to some exceptions not relevant to this paper, the Supreme Court of Canada ruled in favour of the federal government.

15. For convenience, the CNLOPB and the CNSOPB are referred to individually as the Board and, collectively, as the Boards.

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

17. R.S.C 1985, c. O-7.

18. S.C. 1980-81-82-83, c.81.

19. Now the *Public Lands Grants Act*, R.S.C. 1985, c. P-30.

then later under the *Territorial Lands Act*.[20] These regulations date back to 1914 and continued in force with amendments from time to time until 1982, when the regulations were superceded (with some exceptions) by the *Canada Oil and Gas Act*. The various regulations responded to the perceived policy concerns of the day, including a need to ascertain the extent of northern resources (the development of such resources being seen as a key part of the economic development of the north), and a need to exert Canadian sovereignty in the north and, eventually, on the continental shelf of Canada after the adoption in 1958 of the Geneva *Convention on the Continental Shelf*. This convention affirmed that coastal states exercise sovereign rights over the adjacent continental shelf for the purpose of exploring and exploiting the natural resources.[21] The *Canada Oil and Gas Act* also addressed a growing concern over Canadian ownership and control of Canada's strategic oil and gas resources. The promulgation in 1961 of the *Canada Oil and Gas Land Regulations*[22] can be seen as the beginning of the modern era of land tenure for the Canadian north and offshore areas.

The regime established by the 1961 *Land Regulations* can be characterized as intentionally generous to industry, with minimal restrictions on entry and with Canadian ownership requirements attaching only to the later lease stage of the licensing system, not the initial exploratory permit stage. In a speech describing the regime to the Mines Ministers' Conference in Quebec on 18 October 1960, the Honourable Alvin Hamilton stated:

> These regulations are designed, first of all, to encourage exploitation and assessment of resources. For the time being, we can afford to forego maximum short term cash returns but we cannot afford to continue in ignorance of what resources we have.
>
> ...
>
> Obviously, oil companies are not going to spend hundreds of millions of dollars on exploration, just to oblige government. The regulations must offer a reasonable prospect of a worthwhile return on this investment. In the final analysis, this means a competitive cost for... oil delivered to market.
>
> ...
>
> Low cost oil means bolder land patterns in permit and lease. It means keeping down land acquisition costs. It means not drilling more wells

20. R.S.C 1985, c.T-7.
21. *Convention on the Law of the Sea: The Continental Shelf*, UN Doc. A/Conf. 13/1.52-L.55 (1958), Art. 2.
22. P.C. 1961-797, promulgated 6 June 1961 [1961 *Land Regulations*].

> than are necessary to fully exploit a "basin", and it means unitized operations of pools. The new regulations provide for these conditions. In this context, I might just mention in passing that we are endeavouring to collaborate as closely as we can with the oil and gas industry.

The government's enunciation of the purpose and effect of the new regime could hardly have been clearer. Furthermore, the direct involvement of industry in designing the regime was openly acknowledged. Measured against the government of the day's own criteria, the 1961 *Land Regulations* were successful in stimulating frontier exploration efforts, adding to the geological knowledge base and asserting, in a demonstrable way, Canada's claim to sovereignty in the far north.

With the benefit of hindsight, however, it may be said that the very success of the regime instituted by the 1961 *Land Regulations* was to be its undoing. Viewed from another perspective, the result of the regime was that the oil and gas rights to vast areas of the North (and later southern offshore areas) had been disposed of on terms that did not result in work actually being undertaken on all areas held under permit, yet granted tenure that might extend, in some cases, into the 21st Century.[23] By the late 1960s, particularly in the wake of the discovery of petroleum in Prudhoe Bay in 1968, the federal government had begun to have second thoughts about the wisdom of its earlier generosity and began designing a new land management regime for Canada's offshore and northern regions.

The first official action in this exercise was the revocation on 11 May 1970 of *Oil and Gas Land Order* No. 1-1961,[24] which had previously enabled a permittee to avoid the fifty per cent relinquishment requirement contained in the 1961 *Land Regulations* by giving the permittee the right to lease corridor acreage subject to the payment of an incremental royalty. Corridor acreage was potentially valuable acreage discovered by industry effort that reverted to the Crown and became available for further disposition or, possibly, further exploration and development by the Crown itself. The government's action precipitated the first allegations of interference with acquired or vested rights. These allegations would persist through the 1970s and later under the National Energy Program (NEP) announced on 28 October 1980.

The federal government's review exercise encountered a series of unforeseen events that resulted in the repeated postponement of its completion. In August 1972, the Atlantic Provinces and Quebec announced

23. For a detailed criticism of the 1961 *Land Regulations*, see Thompson & Crommelin, "Canada's Petroleum Leasing Policy–A Cornucopia for Whom?" The Can. Forum (June-July 1973).
24. S.O.R./61-461, promulgated 12 October 1961 and revoked by S.O.R./70-184.

an agreement among themselves to avoid the problem of constitutional jurisdiction over offshore areas by negotiating directly with Ottawa. The federal government would have found it difficult to proceed unilaterally with an overhaul of its regulatory regime (which applied to the East Coast as well as to the North) in the face of this development. Then, in December 1973, the Middle East oil embargo occurred, resulting in the first of the international oil price shocks of the 1970s, which added a new dimension to energy policy-making.

By May 1976, however, the federal government was ready to proceed and tabled its Statement of Policy entitled *Proposed Petroleum and Natural Gas Act and New Canada Oil and Gas Land Regulations*, subsequently known as the "Green paper." Bill C-20 was tabled in the House of Commons and was intended to implement this new policy. Bill C-20 died on the parliamentary agenda, but in 1977 the government was able to implement many of its features by a major overhaul of the 1961 *Land Regulations* themselves. These 1977 amendments became known as the "Bridging Regulations."[25] Henceforth, new land issuances were to be on the basis of exploration agreements containing work commitments for an area comprised of more or less contiguous grids, in response to competitive calls for bids. The newly established Petro-Canada was given certain special rights.

IV. *The National Energy Program (NEP)*

The NEP was implemented in response to concerns over increasing costs of imported oil and a lack of stability in international sources of supply brought on by Middle East embargoes and substantial price escalations engineered by the Organization of Petroleum Exporting Countries. The policy objectives of the NEP included:

a. the accelerated exploration and development of Canadian oil and gas resources particularly in the north and offshore areas under federal jurisdiction with a view to attaining energy self-sufficiency and security of supply, such exploration and development being spurred by a compulsory fallow field process combined with government grants under the Petroleum Incentives Program;

b. the attainment of a greater degree of Canadian ownership in the upstream Canadian oil and gas industry spurred by incentives under the Petroleum Incentives Program generally and, preferentially,

25. P.C. 1977-2155, promulgated 3 August 1977, and P.C. 1977-3160, promulgated 13 November 1977.

for exploration activities undertaken on federal lands and for exploration by entities having a higher degree of Canadian ownership and control;

c. greater direct federal government involvement in the upstream Canadian oil and gas industry through the reservation to the federal government of a carried interest in oil and gas production projects on federal lands (the so-called Crown share) and the use of Petro-Canada, then a federal Crown corporation, as the government's window on the industry; and

d. new tax measures intended to redress the perceived fiscal imbalance created by significantly increased resource revenues flowing to the treasuries of the oil and gas producing provinces.

With the passage of over twenty-five years, it should not be forgotten that a major aspect of the NEP was in fact a fallow field exercise intended to increase exploration and development activity in northern and offshore areas held under permits and leases issued pursuant to the *Canada Oil and Gas Land Regulations*.[26] As noted above, the tenure system under the regulations was intended to be generous. Over time, the system came to be seen by policy makers as overly generous to the oil companies and not conducive to the desired level of exploration and development activity. The legislative response is found in the *Canada Oil and Gas Act*, a resurrected version of the earlier Bill C-20.

The new *Canada Oil and Gas Act* required the holders of all former permits, former special renewal permits, and former exploration agreements issued under the regulations to negotiate new exploration agreements with the federal government, failing which the lands under such permits and agreements were deemed to be surrendered and to become Crown reserve lands.[27] Similarly, the holders of all former leases issued under the regulations that had not produced oil or gas other than for test purposes were required to do the same, failing which the lands under such leases were deemed to be surrendered and to become Crown reserve lands.[28] Exceptions were made for lands governed by the Normal Wells Agreement of 1944[29] and several grandfathered leases that had already produced commercially.[30] In effect, virtually all Crown lands under licence

26. C.R.C., c. 1518.
27. *Supra* note 18, s. 63.
28. *Ibid.* s. 64 (1), (2) and (3).
29. *Ibid.* s. 64(4).
30. *Ibid.* s. 64 (5).

to the oil companies were to be surrendered unless the oil companies negotiated new exploration agreements. The legislation was administered by the Canada Oil and Gas Lands Administration (COGLA). It was the policy of COGLA that exploration agreements contain new seismic and drilling obligations and periodic land relinquishment. Needless to say, this fallow field initiative by the federal government was extremely unpopular with oil companies and was viewed by them as confiscatory in nature. In the end, approximately two hundred exploration agreements were negotiated by COGLA with the industry but, interestingly, only a handful of exploration agreements were ever actually signed by the oil companies. The industry maintained a strong lobby effort over several years to have the legislation amended. It did not want to be seen to have accepted the confiscatory aspects of the *Act*, notably the reservation of the twenty-five per cent Crown share, the intrusiveness of the fallow field initiative in the affairs of the oil companies and what was perceived as an excessive degree of ministerial discretion inherent in the *Canada Oil and Gas Act*. The enactment in 1987 of the *Canada Petroleum Resources Act*[31] was essentially a response to industry objections to the NEP.

The confiscatory nature of certain aspects of the *Canada Oil and Gas Act* was obvious to the drafters of the legislation. So too were the implications of certain decisions of the Supreme Court of Canada. In the absence of constitutional protection of private property rights, legislatures may interfere with vested or acquired rights but must do so explicitly. *Spooner Oils Ltd. v. Turner Valley Gas Conservation Board*[32] is often cited for the proposition that there is a presumption that vested or acquired rights are not to be interfered with legislatively unless the legislation expressly or by unavoidable inference permits such interference. There is also a common law proposition that there is an implied right to compensation for the deprivation of property, which proposition was affirmed by the Supreme Court of Canada in *Manitoba Fisheries Ltd. v. the Queen*.[33] This implied right may be overridden by express statutory language.[34] With these considerations in mind, section 61(1) of the *Canada Oil and Gas Act* states that "the interests provided for under this Act replace all oil and gas rights or prospects thereof acquired or vested in relation to Canada lands prior to the coming into force of this Act." Section 61(2) goes on to provide that

31. *Supra* note 16.
32. [1933] 4 D.L.R. 545 (S.C.C.).
33. (1978), 88 D.L.R. (3d) 462 (S.C.C.).
34. See further, R. J. Harrison, "The Legal Characterization of Petroleum Licences" (1980) 58 Can. B. Rev. 483.

> no party shall have any right to claim or receive any compensation, damages, indemnity or other form of relief from Her Majesty in right of Canada ... for any acquired, vested or future right or entitlement or any prospect thereof that is replaced or otherwise affected by this Act, or for any duty or liability imposed on that party by this Act.[35]

The legislative intent could hardly have been made more clear.

The oil industry viewed the fallow field initiative established by the *Canada Oil and Gas Act* together with the reservation of the Crown share as unwarranted and interventionist. Indeed, it was considered so draconian as to elicit diplomatic intervention (ultimately, to no avail) by the United States by way of an exchange of correspondence between the Secretary of State and Canada's Minister of External Affairs. The *Canada Oil and Gas Act* did, however, give statutory recognition to the concept of the significant discovery and the right to indefinite tenure in respect of lands containing a significant discovery.[36] This appears to be a recognition that the fallow field exercise was sweeping and confiscatory in nature. The *Act* provided that the term of an exploration agreement in respect of lands subject to a significant discovery declaration would be extended indefinitely for so long as the declaration remained in force. The *Act* recognized that the northern frontier and the offshore areas were difficult and expensive areas in which to conduct oil and gas operations and that, having regard to the technical challenges and enormous capital requirements of production projects, a long term intermediate form of land tenure was appropriate. From the government's perspective as resource owner, there needed to be countervailing statutory levers to encourage or force activity if need be. Accordingly, the *Canada Oil and Gas Act* reserved to government the power to order drilling operations as the *quid pro quo* for the indefinite tenure afforded to significant discoveries and commercial discoveries. With some modifications and refinements, the basic tenure system was carried forward under the *Canada Petroleum Resources Act*, which legislation replaced the *Canada Oil and Gas Act* and formed the basis for the *Accord Acts*. The current CCS tenure system and related fallow field issues are discussed later in this paper. Ironically, current concerns over potential fallow field issues in respect of the CCS can be traced to the

35. *Supra* note 18, s. 61(1) and (2).

36. See *supra* note 18. The definition of significant discovery was first introduced in the Bridging Regulations, *supra* note 25, but for a somewhat different purpose. Under the Bridging Regulations, the making of a significant discovery allowed the licence holder to opt for the issuance of a special renewal permit in lieu of making a lease selection, thus avoiding relinquishment of lands that otherwise would have been required.

earlier fallow field initiative of the NEP and the legislative response to opposition thereto.

V. *The U.K. experience*

Tenure in the UKCS is governed by the *Petroleum Act 1998*.[37] This *Act* consolidates and replaces the *Petroleum (Production) Act 1934*[38] and the *Petroleum and Submarine Pipelines Act 1975*.[39] Under the 1998 *Act* and its predecessor legislation, licences are issued for exploration and development of oil and gas resources in the UKCS. The licences incorporate various model clauses set forth in regulations made from time to time. The Secretary of State is authorized under the *Act* to exclude or modify the model clauses in particular cases. The 1998 *Act* consolidates and to some extent replaces the various model clauses incorporated from time to time under the earlier legislation.[40] While the legislation authorizes the granting of licences, it does not set out in detail the rights and obligations of licensees. To understand what these rights and obligations are, one must look to the model clauses in force at the time a particular licence is granted. Having regard to the lengthy history of the legislation and shifting policy objectives over time, this is not a simple task. Fortunately, a summary of the tenure system exists[41] and a good overview of the licensing system is available from the Department of Trade and Industry.[42]

While there are several types of licences available, there is not a three-tiered tenure system comparable to the one under the *Accord Acts*. While there is a seaward area exploration licence, it grants only non-exclusive, rather limited exploration rights and, unlike the exploration licence under the *Accord Acts*, it does not confer exclusive rights to acquire a production licence in respect of discoveries made. The type of licence relevant to the topic of this paper is the seaward area production licence which is granted pursuant to a competitive public tender process. Offshore licensing began in the 1960s with the rapid development of the North Sea. There are several

37. (U.K.), 1998, c.17, as amended [1998 *Act*]. Ministerial functions under this legislation are exercised by the Secretary of State for Trade and Industry (DTI).

38. (U.K.), 1934, c. 36, as amended.

39. (U.K.), 1975, c. 74, as amended.

40. See *Petroleum (Current Model Clauses) Order 1999*, S.I. 1999/160 and the *Petroleum Licensing (Exploration and Production) (Seaward and Landward Areas)Regulations 2004*, S.I. 2004/352.

41. See T.C. Daintith, G.D.M. Willoughby & A.D.G. Hill, *United Kingdom Oil and Gas Law*, 3d ed. by A.D.G. Hill (London: Sweet & Maxwell, 2003) Vol. 1 at 1121 *et seq.* and Vol. 3 at 5731-5372/7 [Hill].

42. See DTI Licensing: Overview at <http://www.org.dti.gov.uk/upstream/licensing/overview.htm>.

forms of seaward area production licences, namely the standard licence, frontier area licence and the promote licence.[43] As pointed out by Hill:

> Certain of the licence clauses have always had as their aim the encouragement of specific exploration work in a timely fashion. Traditionally the approach has been to grant the licence for a relatively short initial period during which ... certain specified exploration had to be carried out. This work programme will have been agreed between the licensees and the Department of Trade and Industry ... prior to the award of the licence. Conditionally upon this work programme having been carried out, the licensee is given the right, on surrendering a specified proportion of the originally licensed area at the end of this initial period, to continue the licence as to the remaining area for a further term considered long enough to enable any discoveries that had been made to be developed and depleted before the licence expires.[44]

Currently, a typical seaward area production licence has three periods or terms and is designed to follow the typical lifecycle of a field, namely exploration, appraisal and production. This is similar in many respects to the three-tiered tenure system under the *Accord Acts*. The initial term is four years but may be longer for frontier licences. The licence expires at the end of the initial term unless the required work program has been completed. At that time, a fixed amount of acreage (usually fifty per cent) must be relinquished. The second term is for a period of four years and is intended for appraisal and development. The licence expires at the end of the second term unless the Secretary of State has approved a development plan for commercial discoveries. The third term is intended for production and lasts for eighteen years. The evolution of the stricter terms and conditions of the current form of seaward production licence (i.e. shorter initial and second terms, compulsory land relinquishment and mandatory work program usually comprising seismic surveying and the drilling of one or more wells) reflects the Department's policy that oil companies must work their licences. Escalating annual rentals based on acreage reinforce that policy. The Department of Trade and Industry positively encourages the surrender of acreage unless the licensee actually intends to work it.[45]

43. The frontier area licence is similar to the standard licence with modifications to accommodate the time and technical requirements inherent in the more difficult operating conditions of frontier areas. The promote licence represents an innovative approach to stimulate activity through the granting of licences to companies which may not have the financial or technical resources to conduct offshore operations themselves but which may have novel ideas as to how to do so in respect of fallow acreage. It is hoped that such new ideas will be developed and promoted to operators with the requisite capacity to undertake operations adopting such ideas.

44. *Supra* note 41, Vol.1 at 1123.

45. *Supra* note 42.

The history of the UK offshore tenure system can be seen as a series of amendments to the model clauses contained in seaward production licences in an effort to encourage exploration and development activity. Nevertheless, as Hill notes:

> Further deliberation on appropriate ways to promote and accelerate drilling and production activity resulted in the wholesale abandonment for the 20th licensing round, opened in January 2002, of the approach to term of licence, surrender and relinquishment reflected in the amendments to model clauses made in 1996. The Progressing Partnership Work Group set up by PILOT, after examining the structure and operation of the current UKCS licensing regime with a view to eliminating factors that acted to limit or delay successful drilling and production activities, concluded that the standard UKCS approach of long licence terms and low annual rentals, combined with limited relinquishment and activity obligations, provides an environment where there is too little pressure on licensees to deliver value from their licences. From this flowed recommendations, which have been accepted by DTI, first to adopt a new approach for future licences, starting with those awarded in the 20th round, and secondly to improve performance under existing licences, specifically on fallow blocks and fallow discoveries.[46]

Evidently experimentation over the years through modification of licence terms and conditions, the traditional resource management lever utilized by government in its capacity as resource owner, was not considered adequate to meet government policy objectives. Accordingly, the U.K. fallow field initiative was implemented in 2002. At that time there were over 300 undeveloped discoveries on the UKCS estimated to contain more than six billion barrels of oil equivalent.[47] The U.K. fallow field initiative is significantly different from the fallow field exercise undertaken by Canada under the NEP through the *Canada Oil and Gas Act*. The U.K. approach is not a statutorily imposed scheme with retrospective effect but, rather, operates prospectively through the use of modified licence terms and conditions offered under future licensing rounds to which industry is free to respond as it sees fit. It also operates retrospectively through moral suasion and government-industry cooperation.

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46. *Supra* note 41, Vol.1 at 1125.

47. See Colin Cranfield & Peter Naylor, "Unlocking the Potential from UKCS Low Deliverability Reservoirs" (Paper presented to SPE/EUROPEL, Aberdeen, 29-31 October 2002) [unpublished], online: UK Department for business, Enterprise and Regulatory Reform <http://www.og.berr.gov.uk/information/papers/index.htm>. For a concise and informative summary of the U.K. fallow field initiative see Colin Cranfield, "DTI/PILOT Initiatives to Promote Exploration and New Field Development", online: (2003) No. 4 SHARP IOR eNewsletter <http.//ior.senergyltd.com/issue 4/Articles/DTI_Fallow/index.htm>.

The Department of Trade and Industry studies of undeveloped discoveries and low deliverability reservoirs conclude that there are a number of technical barriers and non-technical barriers to optimum development.[48] As noted by Cranfield, the technical barriers include uncertain reservoir characterization, low reservoir energy, reservoir complexity and low permeability. Non-technical barriers include lack of access to infrastructure, partner and treaty issues, transportation tariffs and outdated gas sales agreements and high cost for licence take-overs and acquisition of existing seismic data. A variety of technical and commercial solutions to these barriers were identified and are summarized in the article by Cranfield.

VI. *U.K. fallow field initiative*

The intent of the U.K. fallow field initiative, introduced in 2002, is to ensure that acreage and potentially economic developments are actively worked. A detailed description of the initiative, the procedures followed and Department of Transport and Industry guidance notes can be found on the Department's website.[49] Hill's summary of the U.K. fallow field process provides a helpful introduction to this complex topic.[50] The initiative is the result of government-industry consultation and is voluntary in nature. There is no fallow field legislation as such; however, amendments to production licence model clauses do afford a legal basis for cancellation of licences or mandatory relinquishment of acreage for failure to carry out additional exploration or development in the fallow field context (at least for licences issued at a time when these clauses were in effect and incorporated by reference). The writer is not aware of any cases challenging the retrospective application of the fallow field initiative even in the absence of a firm statutory basis for its application. What follows is a simplified description of, and commentary on, the U.K. fallow field process which borrows heavily from Hill.[51]

Each year the Department of Transport and Industry makes an assessment of which acreage it considers fallow and posts this on its website. Acreage is considered fallow if no recent significant activity has been carried out in respect of the acreage; that is to say, there has been no drilling for four years or no dedicated seismic for two years. Fallow

48. *Ibid.*

49. <http://www.berr.gov.uk>. The Department is now called Department for Business Enterprise & Regulatory Reform.

50. *Supra* note 41, Vol. 1 at 1126-27.

51. Appendix 1 of this paper sets out the writer's understanding of the U.K. fallow field process in schematic form.

acreage is divided into two groups: Fallow Blocks and Fallow Discoveries. Fallow Blocks comprise acreage on which no discovery has been made. Fallow Discoveries comprise acreage on which a discovery of oil or gas has been made. For this purpose, a discovery is any discovery whether or not determined to be commercially viable. This approximates the CCS significant discovery.

Fallow Blocks are further divided into two categories, namely Fallow A and Fallow B. Fallow A Blocks are blocks held by a technically competent licence holder considered by the Department to be doing all that can be expected with the acreage in the circumstances. The status of Fallow A Blocks is reviewed biannually to determine if they should: (i) remain fallow and thus subject to further review; (ii) be removed from the fallow category because of subsequent significant activity; or (iii) be reclassified as Fallow B. Fallow B Blocks are blocks held by licensees who are unable to make progress due to partner misalignment or commercial barriers. Licensees of Fallow B Blocks have three months to make a proposal to carry out work and thus remove such blocks from fallow status or to attempt to market the blocks to third parties willing to undertake work on the blocks. If some but not all members of a licence group wish to undertake significant activity on the fallow block, those not wishing to participate are expected to sell their interest or withdraw. If significant activity is planned by the end of the year, the block is designated as Fallow BR (Rescued). If no significant activity is planned or no significant activity is completed by the end of the year, the licensee of the Fallow B Block is expected to relinquish the fallow acreage. Fallow B Blocks are released onto LIFT (Licence Information For Transfer) and added to the Fallow Asset Transfer Register. It appears that the U.K. fallow field initiative, in part, attempts to create a secondary market in seaward area production licences supported by computerized access to information, both of a commercial and technical nature.

The process for Fallow Discoveries is similar to that for Fallow Blocks; however, there are some important differences. Fallow Discoveries are divided into Fallow Discovery A and Fallow Discovery B categories. Fallow A Discoveries are further divided into three groups, namely Linked Fallow A, Stranded Fallow A and Active Fallow A. A Linked Fallow A Discovery is a discovery that is associated with a nearby development. If no significant activity is carried out or the associated development does not proceed to completion, the licence holder is expected to sell or relinquish the licence. A Stranded Fallow A Discovery is a discovery where the licensee is not proceeding with development due to a lack of infrastructure or the necessary technology. The fallow status of Stranded Fallow A

Discoveries is reviewed annually and, like Fallow A Blocks, their status is subject to change over time as circumstances change. Active Fallow A Discoveries are discoveries that have been recently designated as fallow by the Department and in respect of which licensees have undertaken to carry out significant activity but have not yet done so. Licensees are expected to carry out such significant activity or to relinquish the relevant acreage.

As noted above, the U.K. seaward area production licence with its initial exploration term followed by its appraisal and development term and finally its production term grants, basically, the same rights conferred sequentially and in distinct licences under the *Accord Acts*. The applicability of the U.K. fallow field initiative as a response to the fallow field dilemma is discussed later in this paper.

VII. *Other U.K. initiatives*

The U.K. fallow field initiative was undertaken in conjunction with, or at least in close proximity with, a variety of other initiatives intended to promote the long term viability of the UKCS oil and gas sector and should be considered in that context. These include among others:

1. shortened licence terms for new licences;
2. the introduction of the promote licence;
3. wider availability of technical data;
4. the establishment of a U.K.-Norway cooperation work group to focus on key matters relating to transportation, optimal use of infrastructure, operational synergies and mutual open-market access;
5. the establishment of PILOT (successor to the Oil and Gas Industry Task Force), a group of leading government and industry representatives whose purpose is to focus on measures to secure the long-term future of the oil and gas industry in the U.K.;
6. the introduction of a new voluntary commercial code of practice designed to remove what were perceived to be contractual and commercial impediments to offshore development;
7. amendments to the voluntary offshore infrastructure code of practice;
8. the introduction of the Master Deed, a new legal framework designed to accelerate the transfer of UKCS oil and assets and facilitate the entry of new participants (similar in many respects

to the CAPL Assignment Procedure widely used in the Canadian oil and gas industry);

9. the elimination of royalties and the introduction of certain tax changes intended to stimulate development; and
10. reforms to liberalize the U.K. gas transportation, processing and marketing regime.

It is beyond the scope of this paper to consider all of these initiatives but they do provide additional context for understanding the U.K. fallow field initiative. The references cited below offer an introduction to these topics.[52]

VIII. *Canadian east coast offshore fallow issues*

Key to understanding potential fallow field issues in relation to the CCS are the concepts of significant discoveries and commercial discoveries and their relation to the three-tiered tenure system and the statutory options and levers available to address fallow field issues.

1. *Significant discovery*

A significant discovery is not a term of art in the oil and gas industry or a term with a well understood juridical meaning such as the term "paying quantity." Indeed, in *Williams and Meyers Manual of Oil and Gas Terms*[53] the only definition of the term is the legislated definition contained in the *Accord Acts*. The *Accord Acts* define the term as follows:

> Significant discovery means a discovery indicated by the first well on a geological feature that demonstrates by flow testing the existence of hydrocarbons in that feature and, having regard to geological and engineering factors, suggests the existence of an accumulation of hydrocarbons that has the potential for sustained production.[54]

This writer suggests that the statutory definition implies, in oil industry terms, a technical success. It does not imply commerciality but, depending on the circumstances, may suggest that appraisal drilling is justified. It is not a particularly high bar to meet having regard to the consequences under the *Accord Acts* for government and the holders of exploration licences.

52. See Cranfield, *supra* note 47; E. Pennington, "Issues For New Entrants to the UKCS–A Legal Analysis" (2002) 11 Int'l Energy & Tax. Rev. at 281-285; and S. Gyaltsen, "The Master Deed and Changes In the North Sea" (2003) 9 Int'l Energy & Tax. Rev. at 258-260.

53. P.H. Martin & B.M. Kramer, *Williams and Meyers Manual of Oil and Gas Terms*, 13th ed. (Newark: Matthew Bender, 2006).

54. *Federal Accord Act*, *supra* note 13, s. 47.

There are only a handful of cases where the term has been considered.[55] These cases are largely administrative law cases considering the issues of procedural fairness and standard of judicial review and are not, with the exception of the *King's Cove* case, particularly helpful for the interpretation of the term "significant discovery."

In the *King's Cove* case, Petro-Canada had applied to the CNLOPB for a declaration of significant discovery and the matter was referred to the Oil and Gas Committee. After receipt of the Oil and Gas Committee's recommendations, the application was denied. Petro-Canada then brought an application for an order in the nature of certiorari seeking to have the CNLOPB's decision quashed. In the context of considering fallow field issues, the case is interesting because of its discussion of the nature of a significant discovery. Of the five issues identified by the trial judge, one was whether the CNLOPB was entitled to consider the volume of oil and the economics of production in evaluating the potential for "sustained production," a key element of the statutory definition of significant discovery. The Oil and Gas Committee thought so and the CNLOPB agreed. The Oil and Gas Committee in its report to the CNLOPB (portions of which are cited in the trial judge's reasons and reproduced here) indicated that:

> any accumulation of hydrocarbons has some potential to be produced and that the term "potential for sustained production" leaves the reader to ask "for how long" and "at what rate". In the words of the Oil and Gas Committee "a cupful a day forever is sustained production but can hardly be categorized as significant."[56]

Petro-Canada submitted that the CNLOPB erred by considering the size of the hydrocarbon accumulation and the economics of production. The economics of production test, it submitted, was the test applicable to a declaration of commercial discovery. The trial judge disagreed stating:

> Common sense requires consideration of economics and, therefore, of the volume of recoverable oil, in determining the "potential for sustained production". ... I agree with the committee's conclusion that in a broad sense, evidence is required to suggest that the feature is of sufficient magnitude and quality to hold reasonable promise of continuous

55. See *Mobil Oil Canada Ltd. v. Minister of Energy Mines and Resources* (1990), 35 F.T.R. 5; *Mobil Oil Canada, Ltd. v. Canada-Newfoundland Offshore Petroleum Board*, [1994] 1 S.C.R. 202, rev'g (1992), 95 Nfld. & P.E.I.R. 95 (Nfld. C.A.), aff'g (1990), 87 Nfld. & P.E.I. R. 58 (Nfld. T.D.) [*Nautilus*]; *Petro-Canada v. Canada-Newfoundland Offshore Petroleum Board*, (1995) 127 D.L.R. (4th) 483 (Nfld. T.D.) [*King's Cove*]; and *Hibernia Management and Development Company Ltd. v. Canada-Newfoundland Offshore Petroleum Board*, 2007 NLTD 14.

56. *Petro-Canada v. Canada-Newfoundland Offshore Petroleum Board*, [1995] N.J. No. 258.

> production of a volume to warrant the effort of producing it. ... I also agree with the committee's conclusion that the legislation requires the board to look for "some winning combination of size and quality of the accumulation, and technology and economics such that these hydrocarbons could be profitably produced. ... The committee clearly distinguished between the test in the definition of commercial discovery and those for a significant discovery. It properly justified considerations of volume and quality and economics in the latter case as necessary to recognize "reality" and "practicality".[57]

While the legislation does not expressly include an economic test, it is the writer's view that the result in the *King's Cove* case is correct. Without some reference to economics how would one determine that a discovery is significant? Governments do not grant oil and gas rights and oil companies do not conduct exploration simply to achieve technical success. It is reasonable to assume that the legislative intent underlying the definition recognizes this, particularly when the consequence of making a significant discovery is the right to a significant discovery licence and indefinite tenure. The difficulty, of course, is to what extent economics can or should be considered at the significant discovery stage. As one might reasonably expect, this uncertainty is reflected in the CNLOPB and CNSOPB *Joint Guidelines Regarding Applications for Significant and Commercial Discovery Declarations and Amendments*.[58] Governments and oil companies will, having different interests, no doubt have differing views and one might expect further litigation to clarify the point.

2. *Commercial discovery*

Terms such as commercial discovery, commerciality and commercial success are terms that are widely understood in the industry, albeit with certain nuances depending on the context in which the terms are used.

57. *Ibid.*

58. The Joint Guidelines are available on the Boards' websites at <www.cnlopb.nl.ca> and <www.cnsopb.ns.ca>. Interestingly, the Joint Directives state at 11 that "although accumulation and sustained production creates some connotation of volume and economics, the Information required is not intended to be commercially supportive in nature."

Various definitions have been put forward.[59] The common theme is that development of a discovery will result in the licensee recovering its costs and earning a reasonable rate of return or profit. The *Accord Acts* define a commercial discovery, not inconsistent with industry understanding, as follows:

> Commercial Discovery means a discovery of petroleum that has been demonstrated to contain petroleum reserves that justify the investment of capital and effort to bring the discovery to production.[60]

Like the definition of significant discovery, the definition of commercial discovery is not without its difficulties. The potential for controversy lies in what constitutes justification to invest. This entails a consideration of numerous variables that government and industry might disagree on. These include technical matters such as quantity, quality and deliverability of reserves and economic factors such as the appropriate capital structure for the industry generally and for a project in particular, the appropriate rate of return, the costs of capital (debt and equity), predictions regarding future prices for petroleum and anticipated project revenues and the appropriate fiscal terms, that is to say, royalties and taxes. Disputes between government and industry as to what constitutes a commercial discovery must be resolved by negotiation or by litigation. In cases where a hearing before the Oil and Gas Committee is requested, the parties will have the benefit of the recommendations of the Committee to facilitate negotiations or, failing agreement, as part of the record in judicial review proceedings. To date, there is no jurisprudence interpreting the relevant provisions of the *Accord Acts*.

3. *Tenure system*

The three-tiered tenure system applicable to the CCS reflects, in the writer's view, a relatively generous legislative response to certain controversial aspects of the NEP and is intended to provide stability and

59. See Johnston, *supra* note 2 at 296. Johnston defines commercial discovery in the following terms:, "In popular usage, the term applies to any discovery that would be economically feasible to develop under a given fiscal system. As a contractual term, it often applies to the requirement on the part of the contractor to demonstrate to the government that a discovery would be sufficiently profitable to develop from both the contractor's and the government's point of view. A field that satisfied these conditions would then be granted commercial status, and the contractor would then have the right to develop the field." See also chap. 6 for a discussion of exploration versus development thresholds and technical versus commercial success. See also *Williams and Meyers Manual of Oil and Gas Terms, supra* note 53, for definitions of commercial deposit, commercial oil pool, commercial production, commercial quantity, commercial well, production and production in paying quantities and the further references and authorities cited.

60. *Federal Accord Act*, *supra* note 13, s. 47.

fairness. It is also the writer's view that the tenure system and call for bids process under the *Accord Acts* are robust and flexible enough to address most fallow field issues.

The exploration licence available under the *Accord Acts* is an extremely flexible instrument. The licence must contain such terms and conditions as may be prescribed in the regulations and may contain any other terms and conditions, not inconsistent with the statute or the regulations, as may be agreed on by the Board and the licence holder.[61] The legislation is not particularly prescriptive as to the terms and conditions to be included in the licence. Legislatively, one limiting feature is that the term may not exceed nine years and may not be extended or renewed.[62] This affords government a variety of options to deal with fallow field issues, such as length of term, required work programs, escalating rentals, mandatory relinquishment and so forth. As a practical matter, however, the terms and conditions are subject to market constraints inherent in the open and competitive call for bids process required under the *Accord Acts*. Overly onerous terms and conditions will be met with disinterest by the oil industry resulting in disappointing licensing rounds and, ultimately, be counterproductive to government policy objectives. What is attainable depends on perceptions of the prospectivity of the acreage offered and predictions on technical feasibility, costs and revenues.

The production licence is equally flexible. It must be in the form prescribed in the regulations and may contain any terms and conditions, not inconsistent with the statute or the regulations, as may be agreed on by the Board and the licence holder.[63] Fallow field issues can be anticipated and dealt with to a large extent in advance. To avoid disputes, misunderstandings and delays, these terms and conditions may be established in advance and incorporated in the call for bids process. The term of a production licence is twenty-five years and is extended for so long as there is commercial production and may be extended where there are reasonable grounds to believe that commercial production will recommence in the future.[64] While this degree of security of tenure is generous, it is not out of line with other tenure systems generally and is intended to promote investment and development.

61. *Ibid.* s. 67.
62. *Ibid.* s. 69.
63. *Ibid.* s. 81(4).
64. *Ibid.* s. 84. What constitutes reasonable grounds to believe that production will recommence in the future has not yet arisen in that no production licence issued in respect of CCS acreage has reached the end of its primary term.

Again, the significant discovery licence is a flexible instrument. The significant discovery licence must be in the form prescribed in the regulations and may contain any other terms and conditions, not inconsistent with the statute or the regulations, as may be agreed on by the Board and the licence holder.[65] The comments made above in respect of terms and conditions and the call for bids process in the context of exploration licences and production licences apply to the significant discovery licence as well. What is unique about the significant discovery licence and the most generous aspect of the tenure system is its indefinite term. A significant discovery licence remains in force during the same period as the related declaration of significant discovery remains in force.[66]

The making of a call for bids by the Boards is a fundamental decision and, as such, is subject to ministerial approval. The *Accord Acts* do not define fundamental decisions by reference to overarching principles. Rather, fundamental decisions are simply those Board decisions that are stated in the legislation to be fundamental decisions. In other words, fundamental decisions comprise a list, which upon review appears to encompass those Board decisions of greatest importance. Subject to the constraints of the *Accord Acts*, this affords government a degree of political oversight and policy input into Board decisions.

The *Accord Acts* implement a joint federal-provincial resource management scheme. The legislation contemplates that fundamental decisions will be approved at the ministerial level by both levels of government. If consensus cannot be reached, the legislation provides for a sequence of suspensive and overriding vetoes in favour of either the provincial government or federal government, depending on the circumstances, to break deadlocks.[67] In addition, the federal and provincial ministers may jointly issue directives in relation to fundamental decisions, which joint directives are binding on the Boards.[68]

4. *Statutory levers*

The generous nature of the tenure system is, however, tempered by certain statutory levers and mechanisms intended to address fallow field issues, namely the power of the Boards:

1. to make drilling orders and development orders;

65. *Ibid.* s. 73(4).
66. *Ibid.* s. 75(3).
67. *Ibid.* ss. 31-40.
68. *Ibid.* s. 42.

2. to make declarations of significant and commercial discoveries on the Board's own initiative; and
3. to amend or revoke declarations of significant and commercial discoveries.

The Boards may at any time after making a declaration of significant discovery order the licence holder to drill a well in the significant discovery area.[69] The licence in question may be an exploration licence, a significant discovery licence or a production licence. The making of a subsequent declaration of commercial discovery does not mean that the earlier significant discovery declaration is no longer in force where the acreage under the two declarations is the same or there is an overlap. Drilling orders are fundamental decisions and are subject to a hearing before the Oil and Gas Committee if requested by the licence holder. No order may be made within six months of the completion of a well drilled prior to the making of the order or within three years of the completion of the drilling of the discovery well upon which the significant discovery is made. In addition, no order may require the licence holder to drill more than one well at a time.

Apart from these time and number constraints, the legislation does not set limits or conditions on the invocation of the drilling order power. The drilling order power has, however, been scaled back somewhat from that contained in the *Canada Oil and Gas Act* in response to industry objections but, nevertheless, remains an important statutory lever to deal with fallow field concerns. Having regard to the purpose of the power, the lack of statutory limits (apart from timing) on its use, and the technical issues involved, one would expect a considerable degree of curial deference on judicial review of decisions by the Boards to invoke it.[70]

As noted, certain Board decisions are subject to review by the Oil and Gas Committee prior to their implementation.[71] When a hearing is requested, the licence holder may make submissions to the Oil and Gas Committee. The Oil and Gas Committee then makes its recommendations to the Board and the Board is required to consider them but, in the end, such recommendations are not binding on the Board. However, Board decisions in respect of which a hearing is held before the Oil and Gas Committee are subject to judicial review. A hearing before the Oil and Gas Committee

69. *Ibid.* s. 76.
70. *Supra* note 55. Comments made by the courts in the cases cited support this proposition, particularly where the matters in question are of a technical nature.
71. *Federal Accord Act*, *supra* note 13, s. 124.

was not available under the *Canada Oil and Gas Act* but was introduced in the *Canada Petroleum Resources Act* and, in turn, carried forward in the *Accord Acts*. The purpose of the change was to afford licence holders an opportunity to make their case, so to speak, on technical matters and have these considered by the Board. In that regard, it should be noted that the Oil and Gas Committee must have at least two members with specialized, expert or technical knowledge of petroleum.[72] The policy intent of this was to ensure the Board would have the benefit of technical expertise and input in making decisions and to create a more comprehensive record should the decision become subject to judicial review. To be blunt, it was hoped that Board decisions would not be made that were at odds with the technical merits.

The power to issue development orders did not exist under the *Canada Oil and Gas Act*. This power represents a more refined statutory lever to spur development than simple reliance on the drilling order power. Under the *Accord Acts*, the Boards may at any time after making a declaration of commercial discovery give notice to the licence holder, where production has not commenced, stating that after a specified period of not less than six months the term of the licence will be reduced.[73] The order may be made in relation to any portion of the commercial discovery area. In other words, production in one portion of the commercial discovery area does not necessarily prevent the making of a development order in respect of another portion of the same commercial discovery area. During this period, the Boards must provide the licence holder a reasonable opportunity to make submissions as to why an order reducing the term should not be made. Where the Board is of the opinion that it is in the public interest to do so, the Board may then make an order reducing the term of the licence to three years or such longer period as may be specified in the order. If production is commenced within the required period, the order ceases to have effect and is deemed to have been vacated. The purpose of this power is to force development or in its absence to cause a relinquishment of the acreage. As noted above, the making of a declaration of commercial discovery does not shield the licence holder from drilling orders. The development order may be made in respect of acreage held under an exploration licence, significant discovery licence or a production licence. The making of a development order is a fundamental decision subject to ministerial approval and is subject to a hearing before the Oil and Gas Committee if requested by the licence holder.

72. *Ibid.* s. 124.
73. *Ibid.* s. 79.

Whether a declaration of significant discovery is made on the application of the licence holder or at the initiative of the Boards, the areal extent of the acreage subject to the declaration is not cast in stone. The declaration may be revoked if it is later determined that the discovery is not significant or may be amended by increasing or decreasing the areal extent of the acreage if it is later determined that the areal extent of the discovery is different than originally described in the declaration.[74] The same is true of declarations of commercial discovery.[75] The legislation provides for corresponding adjustments in the acreage held under the applicable licences.[76] However, the legislation requires and the *Nautilus* case[77] confirms that such determinations must be based on the results of further drilling. For example, such determinations cannot be made on the basis of a reinterpretation of existing or new seismic data. It is debatable whether this is an appropriate constraint, but the constraint cuts both ways. The intent of the further drilling requirement does serve as a check on arbitrary revocation or amendment at the initiative of government. Board decisions to revoke or amend a declaration of significant or commercial discovery are subject to a hearing before the Oil and Gas Committee if requested by the licence holder. Such decisions are not fundamental decisions requiring ministerial approval.

As can be seen from the design of the legislative scheme, the *Accord Acts* provide an array of levers that can be used to address government fallow field concerns while affording licence holders with a reasonable degree of security of tenure and procedural fairness. Use of the drilling order or development order power does raise important policy issues. The use of these powers by governments is not likely to be welcomed by the industry; their use will become one more factor along with geology and economics in assessing the attractiveness of the CCS as a region in which to invest. To the writer's knowledge, these powers have not, as yet, been invoked or been the subject of judicial consideration.

5. *New Fallow Field Initiatives*

With regard to fallow field issues, the argument can be made that the *Accord Acts* provide a reasonable balance between the interests of government

74. *Ibid.* s. 71.
75. *Ibid.* s. 78(3).
76. *Ibid.* s. 74 and s. 83.
77. *Supra* note 55.

and industry.[78] There remains, however, the potentially contentious issue of imposing additional exploration or development obligations and new relinquishment requirements in respect of existing licences. The terms and conditions of existing licences have already been set. These cannot be retroactively and unilaterally changed in the absence of amendment to the *Accord Acts*. A precedent for doing so was established by the NEP through the enactment of the *Canada Oil and Gas Act*. The wisdom of that policy decision has been thoroughly debated and the current legislative scheme governing the CCS is to a large degree the result of that debate. Legislative change is always an option but would require policy agreement and legislative action at both the federal and provincial level if the joint federal-provincial resource management regime implemented by the *Accord Acts* is to be preserved. Unilateral action by either level of government would result in a return to the jurisdictional quagmire that existed prior to the offshore accords.[79] Short of legislative change, recourse can be had to the existing statutory levers reviewed above.

The U.K. fallow field initiative provides an interesting example of one jurisdiction's response to concerns over the pace of exploration and development and may provide lessons for the CCS. This rather elaborate and sophisticated system is not embedded in legislation and was achieved voluntarily in the context of a statutory regime which this writer submits has fewer statutory levers available to government than exist under the *Accord Acts*. There are, however, other important contextual differences. In contrast to the CCS, the UKCS has a large number of existing licences and operators and the secondary market for trading in licences contemplated by the system has the critical mass to at least be a potentially viable and practical option. The UKCS is a far more mature oil and gas region than the CCS with a well developed infrastructure and large technical data base.

78. That was the legislative intent of the federal government as described in its policy statement, entitled *Canada's Energy Frontiers: A Framework for Investment and Jobs*, released in 1985 by the Department of Energy, Mines and Resources where at 7 it states "The legislative framework for the frontier must be sufficiently flexible to adapt to the varying requirements for joint management and revenue sharing ... At the same time it should, as much as possible, provide consistency in relation to fundamental rights and procedures in all parts of the frontier. The new legislation will reflect this balance." The policy statement at 8 describes the three forms of licences to be made available under the new legislation and the rationale underlying the indefinite term of the significant discovery licence and long term of the production licence. The stated objectives of the federal-provincial accords implemented by the *Accord Acts* reflect the desire to achieve early development of petroleum resources within a stable administrative regime for the industry consistent throughout Canada's offshore areas.

79. See R. E. Quesnel & R. J. Thrasher, "East Coast Project Financing Issues" (2001) 24 Dal. L.J. 214 at 224-27 for a discussion of the constitutional setting and delicate political balance underlying the *Accord Acts*.

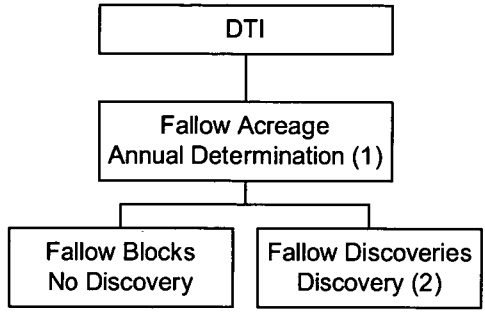
The geology of the UKCS and available markets for UKCS production are, of course, quite different.

Conclusions

Fallow field concerns are a critical aspect in the design of all oil and gas legal regimes. Current fallow field issues with regard to the CCS can only be fully understood in light of the legislative history leading up to the enactment of the *Accord Acts*. That history shows how legislation reflects the particular policy priorities of the government of the day. In the case of the CCS, the relevant legislation started with a generous land tenure system followed by a rather severe fallow field initiative under the NEP and the *Canada Oil and Gas Act.* In response to strong industry opposition to that initiative, the current regime was implemented, first with the enactment of the *Canada Petroleum Resources Act* followed shortly thereafter by enactment of the *Accord Acts*. The current regime was designed to strike a reasonable balance between the interests of government and industry. No regime is perfect; however, in this writer's view there are adequate provisions in the current legislation to deal with fallow field concerns as they arise. To the extent that this view is incorrect, there are options. One would be for government and industry to attempt to achieve a mutually satisfactory resolution of issues through consultation and cooperation inside the existing legislative framework. Another option would be to embark yet again on an exercise in statutory change seeking that elusive balance.

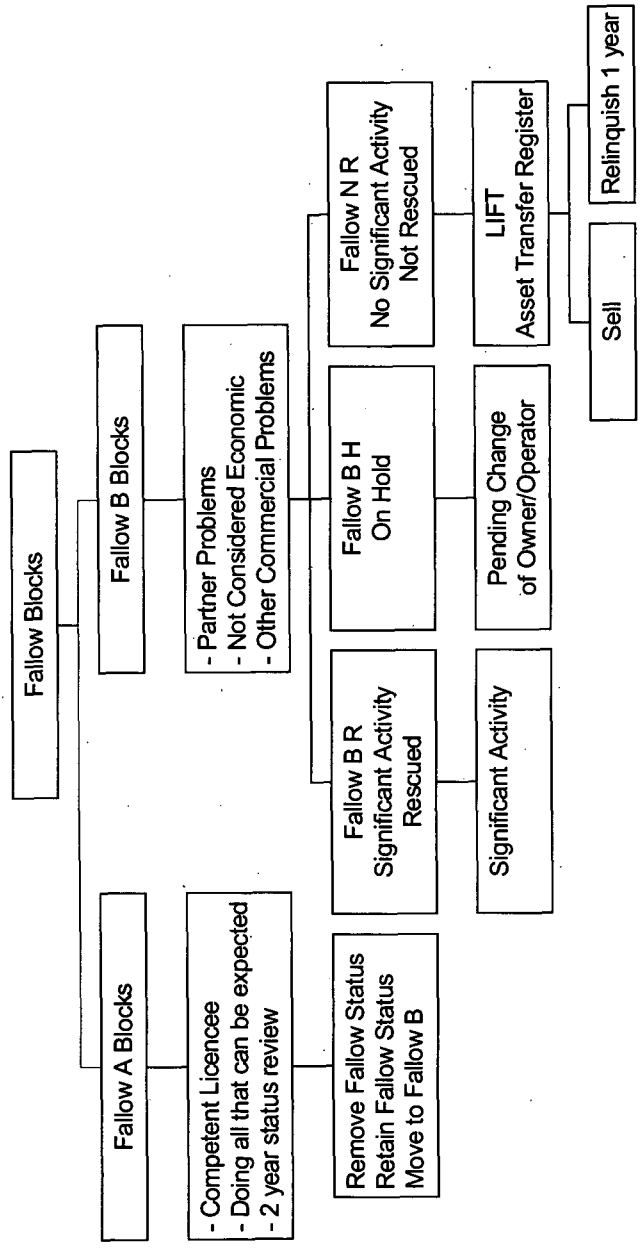
APPENDIX 1
UK FALLOW FIELD PROCESS

ANNUAL DEPARTMENT OF TRADE AND INDUSTRY (DTI) REVIEW



(1) No drilling for 4 years or seismic for 2 years
(2) Discovery need not be commercial

FALLOW BLOCKS



FALLOW DISCOVERIES