



U: OIL AND GAS

ENERGY SOURCES

Canada's vast supply of energy sources include oil, coal, natural gas and uranium.

- > **Canada's wealth of natural resources has contributed to the country's status as a strong global player on the oil and gas stage. Understanding the legal framework related to petroleum and natural gas rights is key to successfully doing business in Canada in this sector.**

1. LAND OWNERSHIP IN CANADA

Land in Canada is held publicly by either the federal or provincial government in the name of Her Majesty the Queen (Crown lands), or privately by individuals, corporations or other stakeholders (freehold lands).

a. Crown lands

In Canada, most mineral rights are owned by the Crown, but the extent of Crown ownership varies from province to province. For instance, in Alberta, the Crown owns 81 per cent of the mineral rights, compared to only 20 per cent in Manitoba.

While the provincial government has general authority over its natural resources, federal jurisdiction can overlap these provincial responsibilities. Examples of this include where Aboriginal interests are affected, if a project crosses provincial or international boundaries, or where a project takes place offshore. When a jurisdictional overlap occurs, both federal and provincial regulators may become involved.

The Crown does not conduct exploration or development of oil and gas resources on its own. Instead, mineral rights are granted to individuals, companies or other entities under a tenure system based on English common law principles. Each province has its own legislation by which its tenure system is administered.

Pursuant to the applicable legislation, exploration documents or production/development documents are granted. Exploration documents are granted to encourage exploration rather than production, and usually cover a much larger geographical area than production/development documents. These documents are typically referred to as licences or permits. Production/development documents are granted for a term or period of time that may be extended indefinitely if certain continuation criteria are met. These documents are typically referred to as leases.

It is important to note that any Crown instrument is subject to the terms of the document itself, along with the applicable provincial/federal legislation incorporated by reference. This legislation specifies many additional material details, such as the amount and manner of calculating the related royalty payments. Additionally, different legislation and regulations for land tenure and project development may exist in different jurisdictions for different types of oil and gas resources, such as oil sands or shale oil.

b. First Nations/Métis/Inuit lands

The Canadian Constitution recognizes three groups of Aboriginal peoples: First Nations, Métis and Inuit. Land ownership that has been recognized by treaties or settlement agreements between these groups and the federal government and/or provincial governments is typically held by the governing body of the respective group and is akin to Crown land ownership.

- First Nations: "First Nations people" refers to status and non-status "Indian" peoples as defined in the *Indian Act* of Canada. First Nations reserve lands are managed and regulated by Indian Oil and Gas Canada, which is a special operating agency within Aboriginal Affairs and Northern Development Canada.
- Métis: Alberta has eight Métis settlements, all located within the northern region of the province and comprising approximately 1.25 million acres of land. Settlement lands are owned in fee simple by the Métis Settlements General Council, and are co-managed with the Alberta government. The law involving Métis rights in other jurisdictions remains uncertain.
- Inuit: Inuit are the Aboriginal peoples who reside in Nunatsiavut (Labrador), Nunavik (Québec), Nunavut and the Inuvialuit Settlement Region of the Northwest Territories. Each of these four Inuit groups has settled land claims, and exploration, development and production of oil and natural gas resources in these areas is subject to those settlement agreements.

c. Freehold lands

A fee simple estate is the highest form of non-government land ownership that exists in Canada. It is usually characterized by the issuance of a certificate of title and is subject only to the rights of the federal and provincial governments. An individual, corporation or other entity with a fee simple estate may choose to explore and develop the natural resources on their lands, or to sell or lease these rights to another party. When a fee simple owner of mineral rights enters into a freehold lease, they are called the "lessor" and the party who leases the mineral rights from the fee simple owner is called the "lessee."

There is no standard freehold lease in the Canadian context. Contracting parties may choose to enter into a variety of lease forms that have evolved over the years. In an effort to address common concerns, the Canadian Association of Petroleum Landmen (CAPL) has developed leasehold forms which are being more readily applied on a go-forward basis. Notwithstanding the fact that many freehold lease forms exist, most will address the following terms in some form or another:

- The mineral rights granted
- The term of the lease and provisions for continuation
- The initial and (if applicable) bonus consideration
- The drilling, delay rental and shut-in requirements
- The shut-in well payments and/or obligations
- The offset well obligations
- The royalty payments
- The applicable division of taxes
- The manner in which a default and/or termination of the lease will be dealt with

It is important to note that freehold leases, like Crown leases, are also subject to applicable provincial/federal legislation, but generally speaking all the terms of the freehold lease are contained within the document itself. Negotiating the most favourable terms prior to execution is therefore crucial.

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2. FEDERAL AND PROVINCIAL REGULATORS

Listed below are some of the regulatory bodies and agencies that may be involved in different oil and gas projects in Canada. Depending on the nature of the project and where it takes place, a project proponent may have to deal with regulators in several jurisdictions.

Federal

The National Energy Board oversees matters such as pipelines or power lines that cross provincial or international boundaries, tolls and tariffs, environmental assessments and the import and export of energy.

Indian Oil and Gas Canada is tasked with fulfilling the federal government's fiduciary and statutory duties with respect to operations taking place on First Nations land. It is also responsible for approving oil and gas lease agreements for First Nation lands (in conjunction with the First Nation), collecting royalties or rent in trust for the band, and may provide consultation services to assist First Nations in their dealings with the petroleum industry.

British Columbia

The Ministry of Energy and Mines is responsible for managing provincially owned resources, as well as issuing and entering into agreements concerning rights to Crown-owned minerals.

The British Columbia Oil and Gas Commission is an independent regulator responsible for monitoring all phases of oil and gas development in the province, including approving oil and gas project applications, consulting with First Nations, ensuring projects are in compliance with provincial legislation, and granting entry to Crown lands.

The Surface Rights Board of British Columbia facilitates dispute resolution between proponents and landowners, and has the power to authorize a right of entry and to determine the appropriate amount of compensation owed.

FEDERAL AND PROVINCIAL REGULATORS (CONTINUED)

Alberta

Alberta Energy is a provincial government ministry responsible for managing provincially owned resources, and issuing and entering into agreements concerning rights to Crown-owned minerals. The Alberta Energy Regulator is an independent regulator responsible for monitoring all phases of oil and gas development in the province, including approving oil and gas project applications, ensuring that projects are in compliance with provincial legislation, including environmental legislation, and granting entry to Crown lands.

The Aboriginal Consultation Office co-ordinates and oversees consultations with First Nations in Alberta. The Surface Rights Board facilitates dealings between industry and land owners, and has the power to make an order for a right of entry and to determine the appropriate amount of compensation owed.

Saskatchewan

The Ministry of the Economy, through a few different departments, serves as the regulator for all aspects of oil and gas development — including issuing and entering into agreements concerning rights to Crown-owned minerals, monitoring all phases of oil and gas development, approving applications, and granting entry to Crown lands. The Surface Rights Board of Arbitration mediates disputes between industry and landowners, and, like its Alberta counterpart, has the power to make an order for a right of entry and to determine the appropriate amount of compensation owed.

Manitoba

The Petroleum Branch of Manitoba Mineral Resources serves as the regulator for all aspects of oil and gas development, including issuing and entering into agreements concerning rights to Crown-owned minerals, monitoring all phases of oil and gas development, approving applications and granting entry to Crown lands. The Surface Rights Board, like the Saskatchewan Surface Rights Board of Arbitration, mediates disputes between industry and land owners, and has the power to make an order for a right of entry and to determine the appropriate amount of compensation owed.

Atlantic Canada

Most oil and gas reserves in Atlantic Canada are offshore, triggering both federal and provincial jurisdiction over the resources. Agreements between the levels of government has produced two primary regulatory agencies: the Canada-Newfoundland and Labrador Offshore Petroleum Board, and the Canada-Nova Scotia Offshore Petroleum Board. Both regulators consist of federal and provincial representatives and regulate every aspect of offshore oil and gas development. Onshore oil and gas development in Atlantic Canada is regulated by the provinces.

Arctic

The northern region of Canada has both on and offshore oil and gas resources. The territorial governments are responsible for onshore management, while offshore oil and gas development is regulated federally by the National Energy Board.

3. TYPICAL AGREEMENTS USED IN THE CANADIAN OIL AND GAS INDUSTRY

The following is a brief summary of some of the agreements that are regularly encountered in the Canadian oil and gas industry.

a. Farmout agreement

This arrangement involves the “farmor,” the beneficial owner — which may or may not be the legal or registered owner — providing another party (the “farmee”) with the opportunity to earn all or a portion of the farmor’s interest under the mineral lease. Earning is generally achieved by requiring the farmee to conduct certain drilling operations on the farmout lands. The farmor often reserves a royalty payable by the farmee, which may or may not be convertible back to a working interest by the farmor.

Some farmout agreements establish an area of mutual interest between the farmor and the farmee for a specified period, pursuant to which each is obligated to offer the other the opportunity to participate in the acquisition of adjoining mineral interests.

b. Joint operating agreement

This arrangement between mineral working interest owners governs the conduct of operations with respect to joint lands, the maintenance of the associated title documents, the ownership and disposition of production, the surrender of joint lands, the abandonment of joint wells, the ability of the joint owners to dispose of or grant security in respect of their working interests, and a variety of other matters. The Joint Operating Agreement (JOA) typically adopts an industry-accepted operating procedure in addition to the specific terms of the JOA. The most widely accepted standardized operating procedure is the CAPL Operating Procedure, particularly in the Western Canadian Sedimentary Basin.

c. Pooling agreement

When the areal extent of individually leased lands is less than the drilling spacing unit prescribed by the relevant governmental authority for conservation purposes and the efficient production of petroleum substances, a pooling agreement can be used to combine two or more leases.

The working interests of the pooling parties in the resulting spacing unit will be equalized, usually on an acreage contribution basis, but occasionally on a reserves basis. This can be effected on a cross-conveyed basis — whereby the actual working interests are conveyed between the parties to the extent necessary — or on a revenue-sharing basis, without an underlying conveyance of working interests.

d. Unitization agreement

This arrangement consolidates all of the working and royalty interests in a common reservoir — which may be comprised of any number of sections of petroleum and/or natural gas rights — with a view to achieving the most economic and efficient production of the substances from the reservoir. The unit is operated as if there is one lease and one operator for the unitized zones and substances. Unit production is distributed in accordance with a participation formula based on an agreed reserves allocation.

There are typically two agreements: a unit agreement among the working and royalty interests, and a unit operating agreement among just the working interest owners.

e. Royalty agreement

This arrangement may create a legal interest in land or simply a contractual agreement for the payment of monies from the royalty payor to the royalty owner. The royalty is usually based on a specified percentage of the total production, and the related agreement will generally address allowable deductions and the royalty holder’s right to take production in kind.

Sometimes the royalty holder will be granted an option to convert the royalty to a working interest.

f. Construction, ownership and operating agreement

This arrangement is the most common type of agreement used by facility owners to address the terms of ownership, the manner in which operations are conducted (during and after construction), the allocation of facility costs, and the assignability of facility interests. This agreement also sets out the basis for allocating facility products to parties delivering petroleum substances to the facility.

4. PROTECTING YOUR INTEREST

For a working interest owner that has a registrable interest in a Crown licence, permit or lease, it is prudent practice to register that interest with the applicable registry. The extent to which a working interest is registrable differs from jurisdiction to jurisdiction, but generally it is difficult to register if you do not own an interest in all of the leased substances, or if your interest is restricted to certain zones or lands.

Whether you have a legal and beneficial interest — as a recognized lessee — or a beneficial interest only — pursuant to a further contractual arrangement in respect of that lease, such as a pooling agreement — in a freehold petroleum and natural gas lease, you can protect your interest by registering a caveat, or similar instrument, at the appropriate land tenure management office. A “caveat,” Latin for “let him beware,” acts as a warning to others that you are claiming an interest in a parcel of land.

5. PROJECT DEVELOPMENT

The exploration, development and production of oil and gas entails many considerations beyond simply obtaining the mineral rights. Even small-scale projects will likely require several different contracts and regulatory approvals, and larger projects can become very complex.

For example, a liquefied natural gas project shipping natural gas from northeastern British Columbia and/or northwestern Alberta to the west coast of Canada for liquefaction, and then onto foreign markets, will involve the following considerations:

- The project will fall within the jurisdiction of the Canadian federal government, and the provincial governments of Alberta and British Columbia.
- It will likely involve the preparation of a detailed feasibility study, the negotiation of project development, gathering, processing, pipeline and marine transportation, and EPC offtake contracts.
- It will require significant consultation with First Nations and other stakeholders.
- The obtainment of export licenses, National Energy Board approval, environmental permits and a variety of other permits and approvals may also be necessary.