Oil & gas

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. As Alberta is home to nearly 80% of total crude oil production in Canada, the following discussion will primarily focus on oil and gas matters in that province, and Western Canada more generally, unless otherwise noted.

1. Ownership of land and mineral rights in Canada
2. Governmental and regulatory bodies
3. Obtaining rights to minerals (Working interest): the Oil and Gas Lease
4. Exercising the Leased Mineral Rights
5. End-of-life Obligations

1. Ownership of land and mineral rights 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). Land ownership may include mineral rights, surface rights, or both. These rights are distinct from one another, and in many cases, particularly in
Alberta, an individual may own the surface rights, while the Crown may hold the underlying mineral rights.

a. Crown lands

In Canada, the provincial Crown owns the majority of mineral rights, but the extent of Crown ownership varies from province to province. For instance, in Alberta, the provincial Crown owns 81% of the mineral rights, compared to only 20% in Manitoba. The federal Crown holds title to mineral rights for lands within national parks and Indian reserves.

The Crown does not conduct exploration or development of oil and gas resources on its own, as there is no national or state-owned oil company in Canada. Instead, mineral rights are granted to individuals, companies or other entities by the appropriate provincial ministry under a tenure system based on English common law principles (with the exception of Québec). Each province has its own legislation that administers its tenure system.

b. Indigenous peoples: First Nations/Métis/Inuit lands

The Canadian Constitution recognizes three groups of Indigenous peoples: First Nations, Métis and Inuit. Land ownership 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**: Oil and gas development on First Nations reserve lands is managed and regulated by Indian Oil and Gas Canada, which is a special federal operating agency within Indigenous Services Canada.

- **Métis**: There are eight Métis settlements comprising approximately 1.25 million acres of land within Alberta. Settlement lands are owned in fee simple by the Métis Settlements General Council, and are co-managed with the Alberta government.

- **Inuit**: Inuit are the Indigenous peoples who reside primarily in Labrador, Northern Québec, Nunavut and the Northwest Territories. These Inuit regions have settled land claims, and these settlement agreements govern exploration, development and production of oil and natural gas resources in these areas.
c. Private lands (Freehold lands)

Freehold landowners, or homesteaders, may hold title to both surface and mineral rights.

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 lease or sell these rights to another party.

2. Governmental and regulatory bodies

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 different jurisdictions.

a. Provincial

Provinces regulate oil and gas activities within their borders. Each province’s government ministries are responsible for managing provincially owned resources, as well as entering into agreements concerning rights to Crown-owned minerals. The regulators are 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. In some jurisdictions, these roles are held by the same entity. In other jurisdictions, such as Alberta and British Columbia, there is an independent regulator. Environmental approvals for oil and gas development are granted by the independent regulator in those provinces.

Western Canada

- **British Columbia**: The Ministry of Energy, Mines and Petroleum Resources is the responsible government ministry in British Columbia. The British Columbia Oil and Gas Commission is the province’s independent regulator, which is also responsible for consulting with First Nations.

- **Alberta**: Alberta Energy is the responsible provincial government ministry, and the Alberta Energy Regulator is the province’s independent regulator. In addition, the
Aboriginal Consultation Office co-ordinates and oversees consultations with First Nations in Alberta.

- **Saskatchewan**: The Ministry of Energy and Resources, through a few different departments, is responsible for all aspects of oil and gas development in Saskatchewan.

- **Manitoba**: The Petroleum Branch of Growth, Enterprise and Trade, is responsible for all aspects of oil and gas development in Manitoba.

These provinces each have their own Surface Rights Board that facilitates dealings between industry and land owners, and has the power to make an order for a right of entry and determine the appropriate amount of compensation owed. On Metis Settlement Land in Alberta, the Metis Settlements Appeal Tribunal deals with such disputes.

**Ontario**

While Canada’s first commercial oil production occurred in Ontario in 1858, the province has less than 1% of total Canadian oil and natural gas production. However, with four refineries in the province that are primarily supplied by Western Canada, Ontario has the second largest refining capacity in Canada, after Alberta.[1]

If applying for a well licence, the responsible ministry is the Ministry of Natural Resources and Forestry, Petroleum Operations Section. The province of Ontario also has an independent regulator, the Ontario Energy Board, regulating natural gas and electricity companies.

**Québec**

While the province does have substantial natural gas reserves, there is currently no commercial crude oil or natural gas production in Québec, in part due to moratoriums and bans on certain activities such as hydraulic fracturing and exploration activities in the Saint-Lawrence River. The province is home to two large refineries. Together, Québec and Atlantic Canada (with its refineries in New Brunswick and Newfoundland & Labrador) have the largest refining capacity in Canada, followed by Western Canada and Ontario.[2]

**b. Federal**

While the provincial government has general authority over its natural resources, federal jurisdiction may overlap these provincial responsibilities. Examples of this include where Indigenous 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 current federal regulator is the Canadian Energy Regulator (formerly the National Energy Board).

The federal regulator 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. The grant of rights to explore for, develop and produce oil and gas on Federal Crown lands and on frontier lands is governed by the Canada Petroleum Resources Act, while oil and gas activities such as exploration, production, processing and transportation are regulated by the Canada Oil and Gas Operations Act. Other federal bodies that may be involved in these matters are the Canadian Environmental Assessment Agency, Fisheries and Oceans Canada, Transport Canada, Natural Resources Canada, as well as Crown – Indigenous Relations and Northern Affairs.

Indian Oil and Gas Canada, which operates pursuant to the Indian Oil and Gas Act, 2009 and the associated 2019 Regulations, is tasked with fulfilling the federal government’s fiduciary and statutory duties with respect to all aspects of oil and gas operations taking place on First Nations land. It is also responsible for approving oil and gas lease agreements for First Nations lands (in conjunction with the First Nation), securing regulatory compliance, collecting royalties or rent in trust for the band, and providing consultation services to First Nations in their dealings with the petroleum industry.

c. Joint Jurisdiction

Atlantic Canada

Most oil and gas reserves in Atlantic Canada are offshore, triggering both federal and provincial jurisdiction over the resources. Indeed, Newfoundland and Labrador is the third largest oil producing province in Canada and all of its production is offshore.\textsuperscript{[3]} Agreements between the different levels of government have 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. These agreements also include revenue sharing arrangements between the federal and provincial governments. Each province regulates onshore oil and gas development within its borders.

Arctic and the Territories

The northern region of Canada has both onshore and offshore oil and gas resources. The
territorial governments are responsible for onshore management, while offshore oil and gas development is regulated federally. Frontier lands (other than those regulated by joint accords), including Nunavut, Hudson Bay, offshore of the Western coast of Canada, Gulf of St. Lawrence, a portion of the Bay of Fundy and onshore Sable Island, are regulated by the Canada Energy Regulator.[4] While the Government of the Northwest Territories has its own energy regulator, the Office of the Regulator of Oil and Gas Operations (OROGO), OROGO has entered into service agreements with the Canada Energy Regulator and the Alberta Energy Regulator, who provide technical support and expertise.

At this time, the Federal Government prohibits offshore oil and gas activities in the Canadian Arctic.

3. Obtaining rights to minerals (Working interest): the Oil and Gas Lease

a. Freehold Petroleum and Natural Gas Rights:

Where mineral rights are owned in fee simple by a private landowner, a freehold lease must be obtained prior to exploration and development on those lands. The fee simple owner of the leased mineral rights is the "lessor", and the party who leases the mineral rights is the "lessee".

There is no standard freehold lease used in Canada. Contracting parties may choose to enter into one of 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 prevalent within industry. Notwithstanding the fact that many freehold lease forms exist, most will include the following terms and clauses:

- Granting clause: specifies the mineral rights that are granted (the substance and the location or depth);
- Duration: the term of the lease and provisions for continuation of the lease (habendum clause);
- Compensation of the Lessor: initial consideration, bonus payment (if applicable), royalty, delay rentals, shut-in royalty;
- Drilling, delay rental and shut-in requirements;
- Drainage and offset well obligations;
- Provisions for abandonment and reclamation; and
The manner in which a default and/or termination of the lease will be addressed.

It is important to note that freehold leases, like Crown leases, are subject to applicable provincial or federal legislation. However, generally speaking, all the terms of the freehold lease are contained within the document itself. Therefore, negotiating the most favourable terms prior to execution is crucial.

b. Crown Petroleum and Natural Gas Rights:

Mineral rights are acquired from the Crown in Alberta by way of leases and licences. Crown leases and licences are granted by the appropriate provincial ministry, usually through public sale or offering. In western Canada, requests may be made for land to be posted for sale with bids submitted through the province’s Electronic Transfer System. Certain circumstances also allow for direct purchases.

The provisions of a Crown Lease are generally similar to the ones found in a Freehold Lease, however, the terms are often pre-established by the legislation and regulations. In Alberta, the initial term of a Crown petroleum and natural gas lease is 5 years, and subject to the lessee establishing that the land in question is productive, may be continued by the Minister. On the other hand, the initial term of a petroleum and natural gas licence may be 2, 4, or 5 years, depending on the region in which the licence is located. The licence may be validated for an intermediate term of 5 years once a well has been drilled on the land. If a Crown lease of licence is not continued, the land reverts back to the Crown.

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

c. Nature of the interest obtained by a lease or licence

A lease gives the lessee a working interest in the minerals covered by the lease. A working interest is a right to produce and dispose of those minerals (a “right to extract” or a “licence to take”). The owner of the working interest also has the responsibility for the
cost of production and disposal of the minerals. However, the mineral rights are leased, not sold. As such, there is no ownership of the minerals in situ, and the proprietary interest only transfers to the lessee once the mineral is extracted.

For a working interest owner that has a registrable interest in a lease, licence or permit, 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. In Alberta, a freehold oil and gas lease is a registerable interest for purposes of the Land Titles Act.

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 may 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.

d. Indigenous and Metis Settlement Lands

On Indigenous and Metis Settlement lands, leases are granted through calls for tender and proposals, competitive bidding, or direct negotiations with First Nation groups. Leases are approved by both the First Nation's Band Council and Indian Oil and Gas Canada. In Alberta, the Metis Settlements Appeals Tribunal acts in a similar manner to the surface rights board for disputes regarding access to land.

4. Exercising the Leased Mineral Rights

a. Access to land

Ownership of mineral rights and surface rights are distinct. As such, if the owner of the mineral rights is different from the owner of the surface rights, a separate surface lease will have to be negotiated with the landowner. In Alberta, a specific separate sum must be provided in consideration for the right of entry to the surface covered by the oil and gas lease.

As mentioned above, if a surface owner and lessee of an oil and gas lease are unable to agree on the terms of a surface lease or in the event of a subsequent dispute, the
provincial Surface Rights Board has the power to authorize a right of entry and determine the appropriate amount of compensation owed.

In the case of surface access on First Nation lands, companies are typically required to submit an environmental review form to both the First Nation and Indian Oil and Gas Canada, as part of its surface lease or right-of-way application.

b. Operating and Drilling Permit Requirements

In addition to obtaining the right to extract the mineral, most jurisdictions require an approval prior to beginning any drilling operations or building activities. In Alberta, the operator must obtain a licence from the Alberta Energy Regulator prior to beginning any activity related to drilling a well or building a facility. The regulator has broad discretion and a number of criteria must be met before a license will be issued. As such, it may refuse to issue a licence entirely, or subject the licence to conditions or restrictions. The regulator must also approve the transfer of any licence.

c. Common Arrangements in Oil and Gas Activities in Canada

**Farmout:** This arrangement involves the beneficial owner (the "farmor") - 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. Generally, earning is achieved by the farmee conducting certain drilling operations on the farmout lands. The farmor often reserves a royalty payable by the farmee, which may or may not be convertible by the farmor to a working interest.

**Joint Operating:** 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 its specific terms. The most widely accepted standardized operating procedure is the CAPL Operating Procedure, particularly in the Western Canadian Sedimentary Basin.

**Spacing Requirements**

- **Pooling:** Drilling spacing units are prescribed by the relevant governmental authority for the purpose of conservation and efficient production of petroleum resources. They
indicate the minimum distance required between wells, and between a well and the boundary of the adjacent tract. When the area covered by individually leased lands is less than the prescribed spacing unit, a pooling agreement may be used to combine two or more leases (or tracts of land). All combined tracts within the drilling spacing unit will be operated as a single unit. All jurisdictions have spacing requirements. In Alberta, pooling arrangements may be voluntary or compulsory, in order to prevent unnecessary and uneconomic wells.

- **Unitization:** A unitization agreement is an agreement to treat the reservoir as a single ownership unit. 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. There are typically two agreements involved: a unit agreement among the working and royalty interests, and a unit operating agreement among just the working interest owners.

**Royalties:** Royalty agreements 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.

**Construction, Ownership and Operating:** Construction, ownership and operation agreements are 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.

**5. End-of-life Obligations**

Applicable legislation in all jurisdictions in Canada requires the abandonment and reclamation of oil and gas infrastructure (including the affected lands) once they have reached the end of their productive life cycle. Where applicable, regulators also prescribe mandatory requirements for owners and operators in such end-of-life activities in order to ensure the protection of the public and the environment.
Abandonment, or decommissioning, consists of the permanent dismantlement of a well or facility. It includes both surface and subsurface abandonment.

Reclamation is returning the land to its original state. A reclamation plan is typically required as part of the application for an energy development project. In Alberta, projects may only be closed and surface leases terminated, once a reclamation certificate has been issued by the Alberta Energy Regulator. Remediation on the other hand is only required in the event of a spill or contamination and involves the performance of environmental site assessments. In Alberta, once a spill has been remediated, companies may apply for a remediation certificate. If remediation is required, it must be performed prior to reclaiming the land. The Alberta Energy Regulator may conduct inspections or audits, and reclamation certificates may be cancelled.

In Alberta, operators of oil and gas facilities remain liable for surface reclamation issues for 25 years and permanently liable for contamination issues.

Due to Western Canada’s aging energy infrastructure and recent economic difficulties, there is an increasing number of abandoned sites that have yet to be properly reclaimed. When companies go bankrupt, and there are no longer any parties that are legally responsible for the site, it will become orphaned. In Alberta, orphaned sites become the responsibility of the Orpan Well Association. Different liability management programs have been implemented in Western Canada in an attempt to ensure that companies will be held responsible for the abandonment and reclamation of the sites they own and operate.

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