

## ENERGY REGULATIONS IN CANADA

A. O. ACKROYD

*SUMMARY: I. The canadian constitution and the ownership of oil and gas. II. Administration and regulation of energy resources in Canada. III. Surface rights and rights of way for drilling and exploration and for transmission and distribution of oil and gas. IV. A unique experiment-oil and gas and the Metis settlements of Alberta.*

Firstly, let me extend my thanks to the office of the Secretary of Energy for the opportunity to speak to your conference about energy regulation in Canada.

Canada, as your geography will show, is approximately five times as large as the land area of Mexico but has only one-fifth of the population of your country. Another significant fact about your Canadian neighbour is that it is often forty times as cold in Canada as the mean temperature of Mexico City. Putting it this way, if it were 20 degrees centigrade in Mexico City, it can be, as I speak, minus twenty degrees centigrade in my province of Alberta.

This fact has had a positive impact on the oil and gas developments in our country. Whereas space heating in most of Mexico is not a problem, this is an essential feature for survival in Canada and the northern parts of the United States of America. As a consequence, natural gas has become an essential energy component of every day life in the province of Alberta to the extent that probably, 95 percent of all homes, both urban and rural are heated through the distribution of natural gas to the furnaces and burner tips in the households of Alberta.

One hundred years ago, coal and wood fires heated the homes in Canada. Today, Canadians look to natural gas more than any other form of energy for the heat that provides comfort to their homes.

## I. THE CANADIAN CONSTITUTION AND THE OWNERSHIP OF OIL AND GAS

When the early provinces of Canada joined together in Confederation in 1867, notably, Ontario, Quebec, and certain of the Atlantic provinces, retained to themselves the rights of ownership of all unsettled lands and more importantly, the rights to the mines and minerals underlying the surface. Mines and minerals were defined to include hydrocarbons underlying the surface such as oil and gas. All other areas of Canada including what we broadly call Western Canada was regarded as a frontier and was given over to the federal jurisdiction of the central government in Ottawa.

Later, as other provinces were carved out of the frontier, notably, Alberta, Saskatchewan, and Manitoba, the federal government continued to retain the right to mines and minerals.

In 1930, the federal government was persuaded that all provinces should be treated equally in terms of their resources and the rights to and jurisdiction over mines and minerals and petroleum were then transferred over to the remaining provinces.

Prior to 1900, many of the earlier settlers across Canada acquired their title to their lands by way of a grant from either the federal government or from the then existing provincial governments and the title to these lands included the right to both the surface and to the underlying mines and minerals. After about 1900, all of the titles to lands acquired from the Crown or the governments were restricted to the surface only and the rights to mines and minerals and petroleum were retained by the granting authority.

In the end result, after 1930, the ownership of mines and minerals including oil and gas resources fell into three general categories:

a) *Federal Government Ownership*: which by the constitution included a jurisdiction over areas set aside for National Parks, areas set aside for Indian Reservations and the remaining frontier areas located in the main in Northern Canada.

b) *Provincial Government Ownership*: this includes ownership of mines and minerals and oil and gas within provincial boundaries except for those reserved for federal jurisdiction such as the National Parks and Indian Reservations to which I have referred. It does include ownership of the mines and minerals underlying what is known as Metis Settlements to which I shall refer in some detail later in this paper.

c) *Frechold or Private Ownership*: this grouping accounts for those private owners whose title to lands were acquired from original grants from the government or governments generally prior to 1900. This may account for only about 10 or 15% of the Canadian mineral resource. Lands Owned or Controlled by the Federal and Provincial Governments and ownership by these governments of subsurface minerals and oil and gas interests or rights are often referred to as “Crown Lands”.

For the purposes of this paper, I shall attempt to restrict my comments to the regulation of oil and gas as energy resources even though coal continues to play a significant role in the generation of electrical energy throughout Canada.

## II. ADMINISTRATION AND REGULATION OF ENERGY RESOURCES IN CANADA

Since federal and provincial ownership accounts for the vast majority of oil and gas interests, the exploration, production, and distribution of this energy resource is largely controlled by legislation and regulation by either the provincial or federal government. The right, licence, or privilege to explore for, drill, or take petroleum and natural gas may have variations, but the oil and gas lease or licences and permits offered or issued by the governments are essentially statutory of legislated forms of contracts. There is little room here for the lawyer to enter into free wheeling negotiations for a special contract with the owner *ie*, the Crown. Where the Crown offers a lease of minerals or oil and gas to an explorer or producer, the Crown sets the annual rent and the economic interest retained by it (most often called a royalty interest) but the Crown seldom incurs any obligation to share with the lessee any expenditures relating to development and production costs. Oil sands developments may be an exception. Both, when one deals with the government or Crown, one generally takes what the government has to offer.

At this point, I must say a few words about the Province of Alberta and its role in the regulation of the production, transportation, and distribution of energy. Although the federal government may retain jurisdiction over a vast area of subsurface mineral resources, it is the provinces and particularly the Province of Alberta which produces the majority of the natural gas and oil marketed within Canada or otherwise exported to the United States. For this reason, the legislation or law and regulations

enacted by the Government of Alberta for the petroleum industry largely set the pattern for the other producing provinces and to a large extent for the federal government. Both Alberta and other provinces along with the federal government have enacted laws and regulations relating to oil and gas which are administered by special agencies or commissions or boards not only for the exploration and production of this energy resource but also for the transmission and distribution of the oil and gas by pipeline.

Pipelines present an interesting study and challenge for the constitutional lawyer. Those pipelines which distribute oil and gas within the boundaries of a province are subject to the laws and regulations of that province (provincial jurisdiction). Where a pipeline is proposed and designed to operate within two or more provinces or takes on interprovincial characteristics, it is subject to federal jurisdiction and is regulated by the federal agency. Gas available for export outside the province must first be approved by the provincial agency (provincial jurisdiction) while transportation of that gas for export through inter-provincial and international pipelines is a matter of federal jurisdiction and is regulated by the federal agency.

Do not despair, the system seems to work.

With respect to those matters under federal jurisdiction (interprovincial pipelines, international pipelines, oil and gas exploration and development in frontier lands), there has been constituted the National Energy Board. It is located in Calgary, Alberta, made up of seven appointed board members with a staff of 280 people. Its counterpart with provincial jurisdiction, using the province of Alberta as an example, is the Alberta Energy and Utilities Board made up of nine appointed members and a staff of approximately 600 employees. The contrast between the size of the two boards probably reflects the difference in the regulatory activity as between the federally controlled oil and gas resources and those of the Province of Alberta.

Over the past two years, there has been a considerable exchange of regulatory information as between the two Canadian Boards and CRE. Commissioner Nocedal probably has an extensive library covering all facets of Canadian oil and gas law by now, particularly those areas governing regulation of public utilities and the regulation of the rate tariffs and prices to be paid by the end users for transmission and distribution of natural gas. I invite those members of the legal profession to use his good resources.

I do not deal in this paper with the aboriginal or Indian rights or titles to oil and gas. This matter is dealt with under Federal law in a special statute called the *Indian Oil and Gas Act*.

In the short time available to deal with this extensive topic, I would like to deal with the areas of activity in the oil and gas energy sector which have generated a considerable amount of activity for the legal profession.

### III. SURFACE RIGHTS AND RIGHTS OF WAY FOR DRILLING AND EXPLORATION AND FOR TRANSMISSION AND DISTRIBUTION OF OIL AND GAS

I have indicated previously in this paper that because of the preponderance of ownership of oil and gas rights by federal and provincial governments the various forms of licences, permits, and other indicia of title and interest are largely legislated forms of contracts. There appears little room for the practising lawyer except to lead his client through the procedural maze leading to a disposition of those minerals to the private sector granting the right to drill a well, construct a pipeline, or gain a franchise to distribute natural gas.

Within this procedural process however, there are areas in which the lawyer becomes most active and this is in the area of determining compensation to the surface rights owner because of the use and resulting damage to the surface of this land occasioned by those who explore and drill for petroleum products and those who construct the facilities to transport and distribute those products in market.

Your regulatory law of Constitutional Article 27 on petroleum is of considerable interest. By Article 10 it is provided that:

“The petroleum industry is a priority public service and takes precedence over any other use of land surface and subsoil as well as over the ownership of a Ejidios or communities, and the temporary or definitive occupation of the expropriation thereof that may be required by the nation or by its petroleum industry, shall proceed by means of legal compensation”.

This statement has a parallel to the development of the law and regulation giving rise to compensation for the use of surface or subsurface of lands for oil and gas developments in Canada.

The origin of the laws in Canada related to land or real property are derivatives from the English Common Law. A title to lands granted by the King or Crown in first instance meant total ownership from the surface to the centre of the earth and to the heavens above. This was called a “title in fee simple”. The title thus granted was nonetheless recognized to be divisible. One could own the title to mines and minerals underlying the surface while title to the surface could be granted to another. The title to subsurface rights of mines and minerals was held to be dominant to that of the owner of the surface. Title to the mines and minerals gave to that person the right to go on the surface and to win, take, and carry away the minerals doing as little damage as may be necessary but without the requirement of compensation to the surface owner whose rights were subservient to those of the mineral owner and limited to a claim for damages if the operations of the mineral owner constituted a nuisance or where an activity extended beyond what might be termed “reasonable use”.

The English law was carried into Canada where mineral and coal developments and quarries were first developed. With the early discoveries of oil and gas at the turn of the century, similar law was applied (with some variation) to those who acquired the rights to drill for oil and gas. Little, if any, compensation was provided for the surface owner.

As noted earlier, the original settlers may have obtained title to the oil and gas along with the surface title. A rather curious anomaly developed in Alberta. Even though the province owns and controls about 85% of the mine and mineral resource, the early discovery in Alberta of oil occurred on privately owned lands, the title to which included the mines, minerals, petroleum, and natural gas. The owner of these private lands became immediately wealthy while his neighbor whose title did not include the mines and minerals suffered the indignity of oil drilling activity on the surface of the land without compensation. This situation obviously gave rise to considerable discontent. The Provincial Government in Alberta chose to deal with this problem by enacting legislation which required that the oil and gas explorer obtain the right from the surface owner to enter upon the land for roadway and well site locations and to pay just compensation for the use of that land over the life of the oil or gas well. Where the surface owner refused to allow entry to his land for drilling or pipeline transmission purposes, a government regulatory authority was created with authority to issue an order granting right of entry and setting the compensation to the surface owner for the use of his land.

Over the past fourty years there has been substantial refinements to the legislation and to the process by which the surface rights owner becomes involved and compensated from the resource development of oil and gas. It is in this process that the legal profession has become most active.

The present legislated arrangement is contained in the *Surface Rights Act* of Alberta and the procedural scheme may be roughly summarized as follows:

i) A party wishing to explore for and produce oil or gas must firstly obtain a disposition of the right to explore for oil and gas from the Crown (province) generally in the form of an oil and gas lease.

ii) the lease holder can then approach the owner or occupier of the surface of the land and seek to obtain the consent of the owner through negotiating the right of entry and by settling the compensation to be paid for the use of the surface. The resulting document is generally referred to as a Surface Lease. The law requires that the compensation to the owner of the surface provide for a one lump sum payment or by annual or periodic payments and for a review every five years of the amount of any compensation payable in respect of which annual or other periodic payments have been selected.

iii) Where no agreement can be reached as between the oil and gas company and the surface owner, the oil and gas lease holder may apply to the government agency (Surface Rights Board) for an interim right of entry upon payment of an entry fee and upon payment of at least 80% of the last offer made by the company to the surface owner for a right of entry.

iv) A final determination of the compensation payable to the surface owner involves a hearing before the Surface Rights Board where the Board hears evidence from the parties and makes a determination of the compensation payable to the surface owner based upon the following factors:

a) The market value of the land based upon the per acre value of its highest approved use;

b) Loss of use of the land by the owner or occupant;

c) These adverse effect on the remaining land caused by the operations;

d) the nuisance, inconvenience, and noise that might be caused by the operations;

e) The damage to the land granted to the operator caused by the operations; and

f) Any other factors that the Board considers proper under the circumstances.

The Board is also authorized as part of the compensation function to determine compensation which is payable to the owner or occupant for:

a) Damage to the land of the occupier or surface owner other than on the areas granted to the operator which occurs as a result of the operations incidental to the operations of the operator of the lands granted.

b) Loss or damage to livestock or other personal property of the occupier or surface owner due to the operations of the operator either on or off the area granted.

c) Time and expenses incurred by the occupier in recovering any livestock that strayed as a result of the operations.

d) Relocation of the owner's or occupant's residence if the residence is required to be relocated as a result of the operations.

A significant feature of this system is that the services of a lawyer in negotiating the surface lease or in appearing before the Board for determination of compensation are regarded as expenses incurred by the surface owner and are therefore payable as part of the compensation awarded to the surface owner. For your interest I have attached to this paper a part of an order of the Surface Rights Board of Alberta outlining the compensation payable to the owner.

A fee for legal services provided to the surface owner by his lawyer generally ranges between \$800.00 and \$1,200.00 or on an average about 5,500 pesos.

As one would anticipate where lands are required along an approved route for a pipeline whether under federal or provincial jurisdiction a similar scheme of compensation has been legislated in favour of the surface owner. Both federal and provincial legislation require that land owner be notified of the proposed route of a pipeline transmission system. Where objection is taken to that route as it may effect the owner of the surface, hearings may be held by the provincial or federal agency to consider the merits of the objection and the company who has applied to construct the pipeline is required to pay all legal and other costs determined to have been reasonably incurred by the surface owner in bringing forward his objection.

It is interesting to note that the system for acquiring lands for the construction of pipelines under federal jurisdiction parallels to a considerable extent the regulatory process established for pipelines built within provincial jurisdiction. In summary, the federal legislation under the *National*



*Energy Board Act* requires that the pipeline company first attempt to obtain necessary land under a “land acquisition agreement”, the form of which is dictated to a considerable extent by the statute which requires that compensation be made either by one lump sum payment or by annual or periodic payments and that the compensation payable be reviewed every five years where annual or periodic payments have been selected. If parties are unable to agree on the terms of a land acquisition agreement, the federal statute provides for the setting up of an arbitration committee which determines the compensation payable to the surface owner based upon a consideration of the following factors where applicable:

- a) The market value of the lands taken by the company.
- b) Where annual or periodic payments are being made pursuant to an agreement or an arbitration decision, changes in the market value referred to in paragraph a) since the agreement or decision or since the last review and adjustment of those payments, as the case may be.
- c) The loss of use to the owner of the lands taken by the company.
- d) The adverse effect of the taking of the lands by the company on the remaining lands or an owner.
- e) The nuisance, inconvenience and noise that may reasonably be expected to be caused by or arise from or in connection with the operations of the company.
- f) The damage to lands in the area of the lands taken by the company that might reasonably be expected to be caused by the operations of the company.
- g) Loss of or damage to livestock or other personal property affected by the operations of the company.
- h) Any special difficulties in relocation of an owner or his property.
- i) Such other factors as the Committee considers proper in the circumstances.

Again, as in the case of the provincial scheme, legal costs and expenses are to be paid by the pipeline company to the surface owner for services of a lawyer for appearances before the arbitration committee. The federal system however, provides that where the amount of compensation awarded to the surface owner by the arbitration committee exceeds 85% of the amount of compensation offered by the company, the company shall pay *all* legal, appraisal, and other costs to have been reasonably incurred by the person asserting the claim for compensation. On the other hand, if the amount of compensation awarded by the arbitration

committee does not exceed 85% of the amount of compensation offered by the company, the legal appraisal and other costs for asserting the claim for compensation are in the discretion of the arbitration committee who may direct that the whole or only a part of those costs be paid by the company.

#### IV. A UNIQUE EXPERIMENT: OIL AND GAS AND THE METIS SETTLEMENTS OF ALBERTA

In the early history of Canada, many of the first explorers and adventurers from England, Scotland, France, and Europe inter-married with Native aboriginal Americans. The results of these unions were people of the “half blood” to be commonly known as the Metis. These people became the fabled voyagers, nomadic hunters, and trappers who were never quite accepted by the Native Indians nor by the European settlers and settlements. Provincial legislation defines a Metis as a person of aboriginal ancestry who identifies with Metis history and culture.

By the 1930's, the frontiers of the west were becoming rapidly settled with those resources necessary for hunting and trapping becoming equally depleted. The threat to the Metis of their culture and identity became recognized by the Government of the Province of Alberta so that in 1939 the Provincial Government passed legislation setting aside eight separate areas of land for the benefit of the Metis people. Those areas comprise in total approximately 1.25 million acres of 505 thousand hectares. As of the date of this paper, some 6000 Metis settlers reside on the eight settlements.

With the assistance and supervision of the Provincial Government, the Metis settlers were encouraged to develop agricultural pursuits and to harvest the resources of the settlements. Some fifty years later, with the aid of the land base accorded to the settlements, each settlement had moved toward a local government autonomy. During that same period, ownership and management of the minerals and oil and gas resources underlying the Metis Settlement lands became a contentious issue as between the Settlements and the agency of the Provincial Government set up to oversee the general administration of the settlements.

The Provincial Government had maintained throughout that it had retained ownership of the mines and minerals and petroleum resources when it granted the land settlements to the Metis. The Metis on the other hand

took the view that it had been accorded the exclusive rights of occupation of the lands as well as the mineral rights and that, in any event, the settlements could preclude pipeline companies or oil and gas companies from entering onto Metis Settlement lands to win and carry away the mineral resource unless consent or permission was granted by the Settlement.

This dispute was ultimately resolved when in 1989, the Government of Alberta entered into an agreement with the Metis Settlements. The agreement became known as the “Alberta Metis Settlement Accord” and formed the basis upon which later legislation was enacted giving each settlement its local government autonomy and providing also for the co-management of the mines, minerals, oil and gas resources underlying the Settlements. The legislation also gave recognition of the eight settlements collectively as an entity known as “The Metis Settlements General Council”.

The Alberta solution is unique in Canada and as far as I can determine, unique in North America. What has evolved is a sharing arrangement so that the local governments (Metis Settlements) and the Provincial Government can both benefit from an oil and gas development.

Up to the time of the Accord, the Provincial Government treated Metis lands much in the same manner as other lands within the Province of Alberta where the Province was the holder of the mines and minerals rights. The right to explore, drill for, and to carry away the oil and gas resource was granted by the Provincial Government to oil and gas companies. Entry onto the surface lands of the Metis Settlements was also obtained under the same laws and procedures as for other land owners in the province.

The Alberta Metis Settlement Accord agreement to which I have referred provided for unique and special treatment for the development of the oil and gas resource underlying Metis lands. In effect, what came about as a result of the Accord Agreement and the enabling legislation that was passed thereafter might be characterized as a partnership in resource development as between the Minister of Energy of Alberta and the collective Metis Settlements. The basis for this partnership is spelled out in a schedule to the *Metis Settlements Act of Alberta* described as the “Co-management Agreement”. It creates different roles for the affected Settlement (where the activity takes place) and for the General Council, the collective body which holds title to the lands.

The highlights of this legislated agreement can be summarized briefly as follows:

a) No lease or disposition of mines or minerals underlying Metis Settlement lands can be granted to the private sector by the Minister of Energy without first referring the proposed public offering to the Metis Settlement and General Council for their approval or rejection of the intended disposition.

b) If either the affected Settlement or the General Council rejects the attended disposition by way of an oil and gas lease, the Minister may still make an offering to the public but must advise that any operator or oil and gas company who has been granted the disposition will not be granted access to the Metis Settlements land to recover the minerals.

c) If the affected Settlement and the General Council agree to approve the granting of a disposition of the oil and gas rights, they advise the Minister as to the conditions that should be included in the offering. These may include the reservation of an overriding royalty and a right to participate as an equity partner (up to 25%) in the development. Subject to these conditions, the oil and gas industry submits bids to the Minister of Energy.

d) The successful bidder then endeavours to negotiate a development agreement with the Metis settlement. If successful, the Minister of Energy grants the operator an oil and gas lease.

The terms of the Development agreement normally include provisions for things like:

a) Environmental protection - consistent with the special role for the lands as a Metis home land.

b) Employment - use of local labour contractors.

c) Surface compensation - for affected land owners.

d) Local property taxes - which may be set by agreement.

e) Royalty overrides - royalties on production paid to the General Council.

f) Participation - the extent to which the General Council directly, or through its associated resource company, will act as a partner in the project.

The consequence of this arrangement is that industry, the Province, Metis Settlements collectively, and the individual affected Settlement all play a role in determining oil and gas development and share in its benefits. Because much of the arrangement is determined by contract—the Development Agreement—the system is very flexible and adjusts to reflect the needs of specific situations.

In summary, the Co-management Agreement gives to the Metis Settlements, individually and collectively, the right to participate in the proc-

ess by which the Government or the Minister of Energy proposes to offer a grant or licence to an oil and gas company to explore for and remove oil and gas from a settlement area.

It also provides for a flexible framework, within which there is considerable flexibility for controlling development and shaping its benefits.

Effectively, local communities control activities on the ground, and takes the direct benefits of employment and taxes. The local communities collectively, through their General Council, structure the arrangements for royalties and participation and consequently provides a vehicle for sharing of longer term benefits.

In short the Province and the Metis Settlements are partners for the development of both the oil and gas and the surface resources are the arm and objective of preserving and enhancing the Metis culture and identity.

I have left with Commissioner Nosedal all relevant agreements, accords, and legislation which support the arrangements that I have described in this paper.