Resources
The Newsletter of the Canadian Institute of Resources Law

No. 14 February 1986

The Atlantic Accord: The Debate Continues

Issue 12 of *Resources* (August 1985) contained an article entitled "A Critical Evaluation of the Atlantic Accord", written by D. Paul Emond of Osgoode Hall Law School. As part of the debate generated by this article, in this issue we present a response to Mr. Emond's article by Ronald G. Penney, a member of the Provincial Negotiating Team on the Atlantic Accord.

The Atlantic Accord A Model of Cooperative Federalism: Response to D. Paul Emond

by Ronald G. Penney

From 1979 to July 1985, Mr. Penney was Newfoundland's Deputy Minister of Justice. Currently on leave of absence from the Public Service, he is Channing Fellow in the Political Science Department of Memorial University.

The Ownership Question

Professor Emond states that the Supreme Court of Canada decided "that Canada alone possesses proprietary and legislative authority over the Continental Shelf." In fact, the court held that continental shelf rights were not "proprietary in the ordinary sense.... In pith and substance they are an extraterritorial manifestation of, and an incident of, the external sovereignty of a coastal State." ([1984] 1 S.C.R. 86 at 97). He then states that "the Accord gives aspects of both to Newfoundland". As pointed out above, there are no proprietary rights that can be given to Newfoundland. More substantively, none of the rights held by the Federal Government have been given to Newfoundland; rather, they are "shared with" Newfoundland. The Atlantic Accord provides a system of joint management over the offshore, implemented through joint legislation which can only be changed by mutual consent.

With one exception (the provincial right to establish royalities and provincial taxes of general application), legislative jurisdiction with respect to oil and gas is also shared between both governments. Even provincial royalties and taxes will have to be established by Parliament in the first instance, through incorporation by reference of the provincial laws.

Policy Making and Dispute Resolution

Professor Emond concludes that "the Board is almost completely divorced from government policy". This is incorrect. First, the Board must act in accordance with the policy of governments as set out in legislation. Second, all fundamental decisions are subject to the approval of the provincial or federal Minister. Third, there is provision for joint ministerial direction on fundamental decisions, the public review process and Canada-Newfoundland benefits.

Thus, the issues left to the Board's discretion are administrative and technical, and similar to the kinds of decisions made by public servants in a department or agency of government.

In regard to the dispute resolution mechanism set out in the Accord, Professor Emond concludes that "the final decision may be very far removed from any government policy". His conclusion results from a failure to distinguish between who "makes" the ultimate decision and who decides "which Minister" has the power to make the ultimate decision. The scheme is quite clear: which Minister has the authority to make fundamental decisions depends on whether self-sufficiency and security of supply have been met. It is the *decision* with respect to who makes the fundamental decision that is made by the arbitration board, not the fundamental decision itself.

The same is true where a provincial Minister's decision on the mode of development is alleged to delay unreasonably the attainment of self-sufficiency and security of supply. It is the issue of unreasonable delay that is addressed in the arbitration. If there is unreasonable delay, the federal Minister has the right to override the decision of the provincial Minister.

As a result, in all cases relating to fundamental decisions a Minister, rather than an arbitration board, has the final say.

Equalization

Before dealing with Professor Emond's comments on equalization, one should take into account certain unpleasant truths about Newfoundland:

- Newfoundland has the highest rate of unemployment in Canada (19.6% as of September, 1985);
- Earned income per capita in Newfoundland is half the national average and that ratio has not improved since Confederation;
- Government services are far below national standards;
- Rates of taxation are the highest in Canada;
- Newfoundland has the highest per capital provincial debt in Canada.

It is true, as Professor Emond points out, that a special equalization phaseout is provided for in the Atlantic Accord. Whether this is an "unhappy precedent" should be viewed in the context of what is set out above. If offshore revenues merely replace equalization on a dollar for dollar basis, the provincial government will not be able to reduce unemployment, increase earned incomes, provide decent public services, reduce taxes to the national average and lower our per capita provincial debt. This is evident because equalization itself has not achieved any of these objectives.

As well, Professor Emond fails to point out that these special equalization payments have a limited time duration. They will end twelve years from the commencement of production.

Market Distortions

Professor Emond thinks the impetus in the Accord towards "rapid development" of the Newfoundland Offshore is somehow contrary to the national interest, the petroleum industry and the environment. It is difficult to understand how reaching security of supply can be contrary to the national interest. The industry clearly wants this resource developed in order to start reaping a return on its substantial investment in the offshore. As to environmental concerns, it is doubtful whether any large scale project carried out in Canada has received the attention and scrutiny of that of the proposed Hibernia project. The Hibernia Review Process and the informed public debate in Newfoundland demonstrates that environmental concerns are not being ignored in a rush for development.

Professor Emond expresses concern that Newfoundland's control over the mode of development allows the "maximizing [of] employment and economic benefits for Newfoundland." How is this contrary to the national interest? It is in the interest of all Canadians that Newfoundland leave its place on the bottom rung of Confederation and receive less equalization over time, and that Newfoundlanders themselves reduce their dependence on personal transfer payments.

It is an accident of history (Newfoundland's entrance into Confederation in 1949 rather than in the mid-1950's, when the concept of continental shelf rights definitely became part of international law) which resulted in today's legal situation. It is only as a result of Confederation that the Newfoundland offshore became part of the Canadian Continental Shelf. The Continental Shelf off Newfoundland, in geographic terms, is a natural prolongation of Newfoundland's land mass and it is only because Newfoundland is part of Canada that this geographic feature appends to Canada. How, then, is it unfair for Newfoundland to expect that the people in its Province should receive the maximum benefits from this resource?

Conclusion

There have been large federal subsidies, through the petroleum incentive program, to encourage frontier exploration for oil and gas. This is hardly unique in the Canadian experience. Canadians throughout the country subsidize the industrial heartland through protectionism and other subsidies for certain industries which serve the interests of central Canada. Subsidization is as Canadian as the Maple Leaf.

The Atlantic Accord, the Western Accord, and, no doubt, similar Accords which may be reached with other coastal provinces, take the federal government out of the resource taxation field. But the federal government, and Canadians as a group, will benefit from increased economic activity in these areas through increased corporate and personal income taxes, and a reduction in federal transfer payments.

The proposed constitutional entrenchment of the Atlantic Accord, much decried by Professor Emond, is to be encouraged as consistent with the long constitutional history of the treatment of resources in Canada. One need only refer to the natural resources agreements of 1930 which transferred control over the resources to the Western Provinces. This entrenchment will also provide some equivalent to the position in Ontario, where the Province has authority over the resources in the Great Lakes from which hydrocarbons have flowed for many decades.

Further, what Canada most needs are prosperous provinces throughout the country, not just at the centre. I therefore hope that this innovative approach to intergovernmental relations will be extended to the other coastal provinces.

Paul Emond Replies:

Policy Making and Dispute Resolution

If the Board is unable to reach consensus, the issue shall be determined by majority vote. On a 7 member Board (3 appointed by Newfoundland, 3 appointed by Canada, and a chair), the Chair's vote could be decisive. The Chair *may* be neither a government appointee nor someone acceptable to other members of the Board, since the Agreement provides that, if the parties are unable to agree on a chair, the position will be filled by the Chief Justice of Newfoundland. It is the prospect of such a person resolving disputes that may offer false hopes that all disputes can be resolved amicably and will reflect public policy. Moreover, the arbitration panel's power to determine which Minister decides an issue may be as important as the Minister's decision, particularly if the two governments are divided on key issues.

Equalization

The principle of equalization is a cornerstone of the Canadian federation. Perhaps the present formula should be changed. It should not, however, be "amended" bilaterally by particular resource developments negotiations.

Market Distortions

Security of supply might be attained more economically elsewhere than from the Hibernia oilfield. For example, cheaper western petroleum might enable Canada, pursuant to the principle of equalization and regional development, to subsidize a Newfoundland aquaculture industry. Now that security of supply and Canadianization of the industry have been largely achieved, perhaps further developments should be left to market forces.

Private Risk Allocation in Offshore Projects

by Constance D. Hunt

The generally positive environmental review of the Hibernia project and Gulf's promising results in the Beaufort Sea may mean that, world oil prices permitting, one or more offshore petroleum projects will become a reality within the next decade. The fact that there have been at least five major accidents during the exploration phase of offshore petroleum activities suggests that, no matter how strict the regulatory regime or how conscientious the industry's approach to safety, offshore development undoubtedly will be accompanied by casualties.

As the legislative framework for offshore petroleum activities has unfolded over the past decade, attention has been focussed upon statutory liability schemes such as the regime for pollution liability added to the Oil and Gas Conservation and Production Act in 1981. Relatively little attention has been paid to the ways which participants in offshore ventures allocate risk among themselves, a matter of increasing importance as certain types of insurance become difficult or impossible to obtain. This note examines two aspects of this complex subject. First, consideration is given to the liability of the offshore operator *vis-a-vis* its joint venturers. Secondly, the extent to which the liability assumed by an operator under a drilling contract can be shared effectively with service contractors is explored.

The Operator's Liability

Because of the high cost of offshore ventures, normally they are carried out by a group of co-venturers whose relationship is governed by an operating agreement. Although no standard form of operating agreement as yet exists in the Canadian offshore, an examination of several currently in use reveals a similar approach to the matter of operator's liability.

Most liabilities incurred by the operator in carrying out operations pursuant to the agreement, whether contractual or tortious, are for the joint account, and are borne by the parties according to their percentage shares in the operation. Non-operators indemnify the operat against claims or liabilities to third parties resulting fi acts or omissions by the operator. Generally, the operator has no liability to non-operators for loss or damage they suffer relative to the operation.

The common exception to this overall regime is that the operator is liable, and the non-operators' indemnities do not apply, if loss results from "the gross negligence or wilful or wanton misconduct of the operator". Some agreements provide that an act or omission by the operator pursuant to the instructions of or with the concurrence of the management committee shall not be deemed to be gross negligence or wilful or wanton misconduct. The "gross negligence" standard gives rise to a number of potential legal problems.

Perhaps most importantly, what does gross negligence mean in a petroleum context? No Canadian court has ever faced this question. The standard appears in many provincial statutes dealing with matters such as the liability of municipalities and the liability of drivers to their gratuitous passengers. The difficulty in drawing a distinction between "negligence" and "gross negligence" has led some commentators to call for statutory reform through the removal of the gross negligence standard.

The Supreme Court of Canada has developed tests for gross negligence in a legislative context. In one case the test is referred to as very great negligence (*Kings* v. *Brennan* (1897), 27 S.C.R. 46). In another, gross negligence is described as "a marked departure from the standard by which responsible and competent

people...govern themselves" (*McCullock* v. *Murray*, [1941] S.C.R. 141 at 143). One scholar has suggested that the length of time during which a risk is negligently not guarded against is an important factor in determining what behaviour amounts to gross negligence. A judge of the Supreme Court has stated that "wilful and wanton misconduct" denotes something subjective, whereas gross negligence may be found entirely apart from what was thought or intended; another has suggested that "wilful and wanton misconduct" denotes conduct more reprehensible than gross negligence (*Studer* v. *Cowper*, [1951] S.C.R. 450).

Canadian cases applying the gross negligence standard in a contractual context are rare. Judges have described conduct amounting to gross negligence as "that want of reasonable care, skill and expedition which may properly be expected", and "wilful negligence amounting to direct misfeasance" (*Janus Co.* v. *Dominion Express Co.* (1907), 13 O.L.R. 211 at 281 (Ont. D.C.); *Grand Trunk Railway* v. *Fitzgerald* (1880), 5 S.C.R. 204 at 213). The paucity of jurisprudence and the generality of these statements demonstrate that the line between "negligence" and "gross negligence" in a particular fact situation may be extremely fine. As a result, there is potential for widely divergent views as to whether or not an operator has breached the standard, and the outcome of litigation over the point would be unpredictable.

A second problem with the gross negligence exception is its relationship to the general standard of care which the agreement imposes upon the operator. The operator must conduct operations "according to existing law, and in a good and workmanlike manner, in accordance with good oilfield practices". If it could be established that a breach of government regulations contributed to a loss, or that the operator failed to comply with industry practices, what impact would this have upon the liability and indemnity arrangements? One might argue that the specific liability standard would govern, rather than the general performance standard. On the other hand, if the two conflict in a situation that is not contemplated explicitly by the specific standard, it could be argued the parties intended the general performance standard to govern. Otherwise, how could one measure the damages owed to the non-operators for the operator's breach of its contractual standard of care? The result of this approach would be that, in such a situation, the usual indemnity would be unenforceable, despite the fact that the breach of regulation or deviation from industry practice might not, in law, be gross negligence.

A third problem is the interplay between the gross negligence exception and the insurance provisions found in many operating agreements. A typical clause states that each party is responsible for insuring its own interest in the joint property with respect to physical damage, and that "such insurance policies shall contain a waiver on the part of the insurer of all rights, by subrogation or otherwise, against the parties". Is the waiver of subrogation binding even if the joint property is damaged as a result of the operator's gross negligence? In other words, is the waiver of subrogation intended to override the liability arrangements in the operating agreement? Many agreements specifically provide that a waiver of subrogation in joint account insurance "shall not extend to acts or ommissions of a non-operator that constitute gross negligence or wilful or wanton misconduct". If such a clause exists, it would be especially difficult to argue that the joint property waiver of subrogation was meant *not* to apply in the face of the operator's gross negligence.

The uneasy fit between the gross negligence exception and other parts of the operating agreement may suggest the need to rethink the wording of certain clauses. The second problem described above could be finessed by specifying that the general performance standard is not intended to override the specific indemnity arrangements. Similarly, the third problem would never arise if the joint property insurance clause contained a proviso similar to that usually attached to the joint account insurance clause. One solution to the first problem would be to define "gross negligence" in the agreement itself. Failing that, the unpredictability of the gross negligence standard may be added to the list of risks taken by offshore ventures.

Sharing the Operator's Liability with Service Contractors

Many drilling contracts utilized in the Canadian offshore contain so-called "knock for knock" indemnity clauses. These make each party responsible for death or injury to its own employees and for loss of their property, regardless of the negligence or fault of any party. The drilling contractor and the operator undertake to indemnify one another for any such claims or costs. These arrangements treat employees of subcontractors as though they were the employees of the party hiring them. Thus, the operator accepts resonsibility for individuals it brings to the work site, such as the employees of its service contractors.

There are a number of ways in which the operator can deal with the risk it has accepted pursuant to the drilling contract. It may be able to insure itself. It may attempt to share this risk, in whole or in part, with other parties, notably service contractors. Both approaches are used in Canada. Where efforts are made to "pass on" the knock for knock arrangement to a service contractor, a typical provision reads, in part: "Contractor shall indemnify...Operator from all claims...by Contractor's employees...without regard to the cause thereof or the negligence of any party...".

The unusual aspect of the knock for knock provision in a service contract is that part of the risk shared by the operator with the service contractor is the risk of negligence by another party, namely, the drilling contractor. In the event of injury to a service contractor's employee resulting from the drilling contractor's negligence, the operator's liability (which has been passed to the service contractor) would arise by virtue of its contract with the drilling contractor. To make it clear that this is the intent of the knock for knock clause in the service contract, the following provision is sometimes used in service contracts:

> The indemnity given by Contractor shall apply notwithstanding that any of the liabilities of Operator to which such indemnity relates arise as a result of any agreement between Operator and a third party...

Especially when this additional provision is not used, the operator might have difficulty enforcing the knock for knock indemnity against the service contractor, if the loss results from the drilling contractor's negligence. The service contractor could argue that the operator has assumed its liability voluntarily (through the contract it entered into with the drilling contractor), and that indemnities do not apply to obligations voluntarily assumed by the indemnitee (*Re Bell Telephone Co. of Canada and Maclean-Hunter Cable TV Ltd.*, [1972] 2 O.R. 288 (Ont. H.C.); *Sedman* v. *Moore,* [1946] O.W.N. 510 (C.A.)). This argument would have particular weight if the service contract pre-dated the drilling contract.

* * *

The paucity of Canadian jurisprudence on risk arrangements in the petroleum context makes it difficult to predict how particular contractual language will be interpreted by the courts. Given the magnitude of the risks involved, however, it behooves lawyers drafting these provisions to do so with care and thought, and to avoid relying on "boiler plate" clauses that may no longer be suitable.

Constance D. Hunt is the Executive Director of the Canadian Institute of Resources Law.

Visiting Scholar

Since January 21 the Institute has been hosting Lars Olav Askheim of the Scandinavian Institute of Maritime Law. Mr. Askheim, a graduate student in law at the University of Oslo, is in Canada to conduct research which will assist him in the preparation of his thesis on the topic "Financing Offshore Development Projects in the North Sea, with an Emphasis on Loans Between Oil Companies". His purpose in coming to Canada is to learn more about the Canadian oil and gas industry in general and, in particular, to see industry project financing in practice. Mr. Askheim will remain at the Institute until the end of May. His visit is being funded by a Mobil Oil grant to the Scandinavian Institute of Maritime Law.

Oil Pollution Legislation

Institute Research Associate Christian Yoder recently testified before the House of Commons Legislative Committee which is reviewing Bill C-75, amendments to the Canada Shipping Act. The changes being considered by the Subcommittee will affect existing law with respect to both ship source and exploration/production source oil pollution and are therefore significant to the oil industry.

Mr. Yoder's testimony to the Sub-committee was based on research he has been conducting for an Institute working paper to be published in the fall of 1986. The paper, tentatively titled "Liability for Oil Pollution on Canada Lands", is being prepared under the auspices of the Institute's Oil and Gas on Canada Lands Project.

Publications

Managing Natural Resources in a Federal State, Essays from the Second Banff Conference on Natural Resources Law, Banff, Alberta, April 17-20, 1985. Edited by J. Owen Saunders. Published by Carswell Legal Publications, 1986. 372 pages hardcover. $62.50.

This book presents a series of essays on the special problems a federal system poses for rational management of natural resources.

The papers address the significant issues that follow from the reality of a joint responsibility for resources management: development and control of northern and offshore oil and gas; revenue sharing; development of resources within federal parks and aboriginal reserve lands; environmental management; and interjurisdictional cooperation and obligations in respect of shared resources such as water.

The essays focus on the legal and constitutional aspects of resources policy and management. They also provide historical, political and economic background to such events as the Atlantic and Western Accords, the development of federal reserve lands and international negotiations respecting pollution and water control. While Canadian concerns are emphasized, comparative treatments of United States and Australian experiences are included, providing a unique and valuable perspective for Canadian readers and a useful reference for those outside Canada.

This book may be ordered from: Carswell Legal Publications, 2330 Midland Avenue, Agincourt, Ontario M1S 1P7 or call toll free 1-800-387-5164. If payment accompanies your order, Carswell will pay for postage and handling.

A Guide to Appearing Before the Surface Rights Board of Alberta, (Second Edition), by Barry Barton and Barbara Roulston. Working Paper 11. 1986. ISBN 0-919269-19-2. 124 p. $15.00

This book is intended to assist people involved in cases before the Surface Rights Board of Alberta. It is particularly directed to the needs of the owners and occupants of land, but it should also be of use to resource companies, landmen, lawyers, appraisers, and others whose work requires an understanding of surface rights negotiations and proceedings. Under the Surface Rights Act of Alberta, a company can be authorized to enter and use land to drill and produce from an oil or gas well, to lay a pipeline, to erect power lines or telephone lines, or to carry out

mining operations. The Act covers Crown land and privately-owned land, and lays down the procedures by which the Surface Rights Board determines the amount of compensation that the operator must pay to the owner.

Chapters One to Four provide a guide to the Surface Rights Act, the ways that an operator can obtain a right of entry on land, procedures before the Board, and the way that compensation is fixed. These chapters are written so that they will be useful to persons who do not have legal training. In Chapter Five, the authors offer a legal analysis of a number of issues that are currently causing difficulties in surface rights law.

The first edition of this Guide, by Laureen D. Ridsdel and Richard J. Bennett, was published in 1982. This second edition deals with the many changes that have occurred since then, including the new Surface Rights Act enacted in 1983. To order this book please write to the Canadian Institute of Resources Law at the address shown below.

A Reference Guide to Mining Legislation in Canada, by Barry Barton, Barbara Roulston, and Nancy Strantz. Working Paper 8. 1985. ISBN 0-919269-15-X. 120 p. $20.00

The Canadian Regulation of Offshore Installations, by Christian G. Yoder. Working Paper 9. 1985. ISBN 0-919269-18-4. 116 p. $15.00

Assignment and Registration of Crown Mineral Interests, by N.D. Bankes. Working Paper 5. 1985. ISBN 0-919269-11-7. 126 p. $15.00

Oil and Gas Conservation on Canada Lands, by Owen L. Anderson. Working Paper 7. 1985. ISBN 0-919269-16-8. 122 p. $15.00

Public Disposition of Natural Resources, Essays from the First Banff Conference on Natural Resources Law, Banff, Alberta, April 12-15, 1983; Nigel Bankes and J. Owen Saunders, eds. ISBN 0-919269-14-1. 366 p. (hardcover) $45.00

Canadian Maritime Law and the Offshore: A Primer, by W. Wylie Spicer. Canadian Continental Shelf Law 3; Working Paper 6. 1984. ISBN 0-919269-12-5. 65 p. $11.00

Fairness in Environmental and Social Impact Assessment Processes, Proceedings of a Seminar, The Banff Centre, February 1-3, 1983; Evangeline S. Case, Peter Z.R. Finkle and Alastair R. Lucas, eds. Proceedings 2. ISBN 0-919269-08-7. 125 p. $15.00

Canadian Electricity Exports: Legal and Regulatory Issues, by Alastair R. Lucas and J. Owen Saunders. Working Paper 3. 1983. ISBN 0-919269-09-5. 40 p. $7.50

The International Legal Context of Petroleum Operations in Canadian Arctic Waters, by Ian Townsend Gault. Canadian Continental Shelf Law 2; Working Paper 4. 1983. ISBN 0-919269-10-9. 76 p. $7.00

Acid Precipitation in North America: The Case for Transboundary Cooperation, by Douglas M. Johnston and Peter Finkle. 1983. ISBN 0-919269-02-8. 75 p. $8.00

Petroleum Operations on the Canadian Continental Margin - The Legal Issues in a Modern Perspective, by Ian Townsend Gault. Canadian Continental Shelf Law 1; Working Paper 2. 1983. ISBN 0-919269-02-8. 113 p. $8.00

Environmental Law in the 1980s: A New Beginning, Proceedings of a Colloquium, The Banff Centre, November 27-29, 1981; Peter Z.R. Finkle and Alastair R. Lucas, eds. Proceedings 1. ISBN 0-919269-05-2. 233 p. $13.50

Environmental Regulation - Its Impact on Major Oil and Gas Projects: Oil Sands and Arctic, by C.D. Hunt and A.R. Lucas. 1980. ISBN 0-919269-00-1. 168 p. $10.95

Resources Law Bibliography. 1980. ISBN 0-919269-01-X. 537 p. $19.95

Resources: The Newsletter of the Canadian Institute of Resources Law. ISSN 0714-5918. Occasional free

Publications are available from:

Canadian Institute of Resources Law
430 Bio-Sciences Building
Faculty of Law
The University of Calgary
Calgary, Alberta, Canada T2N 1N4
Telephone (403) 220-3200
Telex 03-821545

For Postage and Handling please add:
20% Canada, 30% USA, 40% outside North America.

Canada Energy Law Service (ISBN 0-88820-108-7) is a 3 volume looseleaf service published in conjunction with Richard De Boo Limited. It is a guide to the energy tribunals of the western provinces, Ontario, and Canada. For each tribunal considered there is a commentary, a collection of legislation, and a digest of board decisions and applicable judicial cases. Over the long-term the Service will be extended to cover other provinces and the Territories. It is available from:

Richard De Boo Limited
81 Curlew Drive
Don Mills, Ontario M3A 2R1