

focus

on

Northern Oil & Gas

The logo for Fraser Milner Casgrain LLP, featuring the letters "FMC" in white on a blue square background with a thin white arc below it.

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Oil and Gas Significant Discovery Licenses on Frontier Lands in Canada's North

Interests in petroleum on Crown lands in the Northwest Territories and Nunavut are governed by the *Canada Petroleum Resources Act* (CPRA).¹ Operations and development of such leased lands are governed by the *Canada Oil and Gas Operations Act* (COGOA).²

The CPRA applies to all "frontier lands", including "lands that belong to Her Majesty in right of Canada, or in respect of which Her Majesty in right of Canada has the right to dispose of or exploit the natural resources, and that are situated in the Northwest Territories or Nunavut, or in the territorial sea or the continental shelf of Canada."³

The CPRA does not apply to subsurface interests owned by First Nations under the various land claim settlement agreements. Under these agreements, legal title to subsurface petroleum rights was transferred to the respective First Nations on some lands in return for the surrender of claims to subsurface petroleum rights in the remainder of the settlement region. The grant of interests in petroleum on those lands where title is held by First Nations is governed by the terms of the applicable settlement agreement.

¹ R.S.C. 1985, c. 36 (2nd Supp.).

² R.S.C. 1985, c. O-7; see the April 2002, issue of FMC Focus for further discussion of the distinction between Crown lands and lands owned by Aboriginal peoples in the North.

³ Note that the CPRA also governs federal frontier lands on Sable Island and offshore Atlantic provinces, but this bulletin is restricted to discussions of lands in the Northwest Territories and Nunavut.

The CPRA licencing scheme provides three types of interests that may be issued: Exploration Licences (EL); Significant Discovery Licences; and Production Licences. This bulletin will describe the intermediate form of licence, the Significant Discovery Licence (SDL).

The Significant Discovery Licence is intended to encourage exploration of resources in remote lands where there is no immediate prospect for commercial production. Where an explorer encounters a significant discovery but the then current economic conditions are not conducive to exploiting that discovery in a commercially-viable manner, an SDL allows the interest owner to retain rights in its discovery until such time as it becomes commercially reasonable to produce the discovered resources.

DECLARATION OF SIGNIFICANT DISCOVERY

The first step in obtaining an SDL is obtaining a declaration of significant discovery from the National Energy Board (NEB).

The CPRA defines a significant discovery as follows:

"a discovery indicated by the first well on a geological feature that demonstrates by flow testing the existence of hydrocarbons in that feature and, having regard to geological and engineering factors, suggests the existence of an accumulation of hydrocarbons that has potential for sustained production."⁴

⁴ CPRA, s. 2.

Where an interest owner⁵ makes a discovery that it believes is significant, that owner may make an application to the NEB for a declaration of significant discovery.⁶ The process for obtaining such declarations is governed by the *National Energy Board Act* (Canada).⁷ The NEB is required to provide notice to anyone directly affected by the application and, in some circumstances, the NEB must hold a hearing.⁸

SIGNIFICANT DISCOVERY LICENCES

Where a declaration of significant discovery is in force and all or a portion of that area is the subject of an exploration licence, the EL holder may apply for and obtain an SDL for the area of significant discovery that is subject to the EL.⁹ When an SDL is issued in respect of an area, any EL previously issued ceases to have effect in respect of the area covered by the SDL.¹⁰

Where an area of significant discovery extends to Crown reserve lands not under any licence then the Minister may call for bids and issue an SDL pursuant to the bid process.

An SDL gives the following rights to a holder:

- a) the right to explore for, and the exclusive right to drill and test for, petroleum¹¹;
- b) the exclusive right to develop those frontier lands in order to produce petroleum; and
- c) the exclusive right to obtain a production licence.¹²

⁵ an interest owner is defined in the CPRA at s. 2, as anyone who holds an interest in, among other things, an exploration licence, significant discovery licence or production licence. In the context of this bulletin, we discuss the more common instance where the applicant is a holder of an EL.

⁶ CPRA, s. 28(1); additionally, the CPRA empowers the NEB, by its own initiative, to make a declaration of significant discovery on lands contiguous to those under an application where the NEB reasonably believes the significant discovery extends. CPRA, s. 28(2).

⁷ R.S.C. 1985, c. N-7.

⁸ NEB "Guidance Notes for Applicants: Applications for Declaration of Significant Discovery or Commercial Discovery." January, 1997.

⁹ CPRA, s. 30(1). Note that SDLs may also be obtained through a bid sale of Crown reserve lands lying within an area of significant discovery. CPRA, s. 30(2).

¹⁰ CPRA, s. 32(1).

¹¹ The defined term "petroleum" includes natural gas and oil.

¹² CPRA, s. 29. Note that, except for drilling, an SDL does not give exclusive rights to exploration. Other methods of exploration, such as seismic

An SDL takes a prescribed form, but may also contain any other terms and conditions, not inconsistent with the CPRA, as agreed between the Minister and the holder of the licence.¹³ The effective date of an SDL is the date of the application.¹⁴ An SDL is issued for an indefinite term, so long as the significant discovery declaration is in force, and will lapse when a production licence is issued in relation to the same area.¹⁵

Declarations may be amended or revoked by the NEB where, upon further drilling, there are reasonable grounds to believe that a discovery is not a significant discovery or that the lands to which the significant discovery extends differ from the significant discovery area.¹⁶ A declaration of significant discovery may not be amended to decrease the significant discovery area, or revoked, earlier than (a) in the case of a significant discovery area subject to an SDL issued to a holder of an EL that covered the significant discovery area, the date the EL expires, and (b) in the case of a significant discovery area subject to an SDL issued on an area not previously under licence, three years after the effective date of the SDL.¹⁷

Though commonly thought of as having an indefinite term, the term of an SDL is subject to certain limitations. As discussed above, an area of significant discovery may be reduced or the declaration revoked, thus ending the term of the SDL.¹⁸ The Minister¹⁹ may issue a drilling order requiring that the SDL holder drill a well within a specified time period on any portion of the significant discovery area in accordance with directions specified in the order.²⁰ The results of this drilling could affect the status of a significant discovery area declaration. Where the SDL holder does not comply with such order, non-compliance procedures may eventually lead to termination of the SDL.

exploration, may be conducted by anyone who obtains the appropriate approvals and surface access.

¹³ CPRA, s. 30(3).

¹⁴ CPRA, s. 32(2).

¹⁵ CPRA, ss. 32(3) and 42(1).

¹⁶ CPRA, s. 28 (4).

¹⁷ CPRA, s. 28 (5).

¹⁸ see n. 17.

¹⁹ In the case of lands North of 60°, the Minister is the Minister of Indian and Northern Affairs.

²⁰ CPRA, s. 33.

Currently, SDLs grant an interest in all substances from surface to the basement,²¹ and there are no rentals owing during the term of the SDL.²²

When an SDL holder decides that it is commercially viable to produce from any lands under an SDL, it may apply for a production licence. This form of licence will be discussed in a future Focus bulletin.

²¹ Note that this is not statutorily entrenched but merely a current policy of the Northern Oil and Gas Directorate. It is quite reasonable to assume that as production activity increases, this policy will change.

²² "Primer on Oil and Gas Resource Management in Canada's North – 1999 Update" Indian and Northern Affairs Canada.

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