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Giving away the Arctic farm to piddly little companies - Federal (mis)management of northern oil and gas rights.

By Nigel Bankes

Decision commented on:

> The decision of the Minister of Indian Affairs and Northern Development (aka Minister for Aboriginal Affairs and Northern Development, Canada) to award new oil and gas rights pursuant to the 2011-2012 Beaufort Sea & Mackenzie Delta Call for Bids.

On September 12, 2012, the government of Canada announced that it would be granting exploration licences (ELs) to the small and low profile Franklin Petroleum Limited of the UK for six blocks of oil and gas rights in the Beaufort Sea. The ELs will cover over 900,000 hectares of land.

The decision triggered an interesting response from an unexpected quarter. Paul Ziff, the principal of Ziff Energy consultants, a highly respected Calgary based group of energy consultants which routinely does work for both industry and government, commented in the September 21, 2012 edition of the Calgary Herald (at D4) as follows:

> To award such a large quantity of offshore acreage to a piddly little company doesn't seem to be in the public interest. … What we have is a loss of control over a very large part of the Beaufort Sea.

Last year there was a similar award of two blocks of land to another similarly unknown UK company, Arctic Energy and Minerals Ltd (see here) for work proposal bids of $1 million for each block.

So what is this all about?

Is it really the case that the feds still own northern oil and gas resources and that they give them away to piddly little companies in return for trifling work commitments? The answer is "yes," although I don't think that we have seen a give-away on this scale since the giveaways that occurred before the first major discovery of oil and gas resources in the Arctic in Prudhoe Bay (Alaska) in 1969. Following that discovery federal policy makers resolved to be more demanding of international oil companies. This most recent decision looks like a step back in time.

So what are the rules for "disposing" of oil and gas rights in Arctic Canada?

Rule # 1: the feds still set the rules for the NWT, and Nunavut including the Arctic Offshore

Ottawa still retains administration and control of all oil and gas rights in Nunavut and the Northwest Territories (saving those oil and gas rights now recognized to be vested in Inuit organizations and First Nations through the terms of land claim agreements – and they, by the way are much more demanding). The governing legislation is the *Canada Petroleum Resources Act*, RSC 1985, c 36 (2nd Supp) (*CPRA*) which was introduced by the Mulroney administration to replace the former *Canada Oil and Gas Act* (one of the components of the National Energy Program) with its hated "Crown share." Oil and gas rights in Yukon by contrast are held by the Yukon government.

Rule # 2: the nominating process is industry driven

The Government of Canada decides which parcels to put up for nomination based on requests from industry. Notwithstanding a federal cabinet directive (see here) which requires departments to conduct strategic environmental assessments (SEAs) before adopting new polices plans or programs which may have a significant environmental effect, the Department does not conduct an SEA before opening up new areas for bidding. There is a different practice on the east coast where both the Nova Scotia and Newfoundland Boards have been conducting SEAs for new bidding rounds for a number of years. For more discussion see Doelle, Bankes, and Porta, "Using Strategic Environmental Assessments to Guide Oil and Gas Exploration Decisions in the Beaufort Sea: Lessons Learned from Atlantic Canada", posted on SSRN, September 5, 2012.

Rule # 3: the CPRA prescribes a "single bidding variable" for disposing of lands

In order to assure industry that there would be no political interference in the bidding process, section 14(3)(g) of the *CPRA* requires that any call for bids shall specify "the sole criterion that the Minister will apply in assessing bids submitted in response to the call." Thus the Minister, cannot, for example, assess both a work commitment and contribution to the Canadian economy as part of assessing bids. All successful bidders must subscribe to a set of Northern Benefits Requirements but these are little more than bland statements of principle with no real bite. While this arrangement is very favourable to industry and certainly has the advantage of transparency it handcuffs the Minister in evaluating who might be in the best position to explore a block of lands and enhance public interest considerations.

Rule # 4: as a matter of practice, the dominant if not exclusive bidding variable is a "work" bid.

While Alberta, for example, uses a bonus bidding system to dispose of its oil and gas rights, Canada continues to dispose of lands in the Canadian Arctic on the basis of a work bid i.e. the exploration dollars that the bidder is prepared to commit to spend during the term of the EL on activities such as running seismic and drilling exploratory wells. This is justified on the basis that the Arctic is under-explored. The successful bidder must be prepared to put down 25% of the bid amount as a deposit before the EL will be issued. In this case, the winning bid for each block was for a paltry $1.25 million dollars which isn't even enough to get a vessel in the area to run a little seismic. It won't even come close to the cost of drilling a well and yet under the terms of its nine year ELs, the licensee must have drilled an exploratory well within the first five years of the EL in order to retain the EL for the balance of the term.

By contrast the last call for bids in the Central Mackenzie area (June 2012) resulted in two successful work package bids of $76 million and $15 million in a lower cost exploration area (see here). Bids on blocks in the same area in 2011 attracted successful works bids ranging from $1.5 million to $166 million.

It is important to note that the Minister does not have to issue an EL: section 16(1) of the *CPRA* says precisely that: "The Minister is not required to issue an interest as a result of a call for bids."

Rule # 5: Canada does not require bidders to meet a pre-qualification bidding requirement.

The Arctic, and especially the offshore Arctic, is an expensive and unforgiving place in which to drill exploratory wells. There is some reason therefore for wanting to be sure that only the most qualified oil and gas companies backed by significant experience and assets get to bid on offshore blocks. To that end, some jurisdictions such as Norway, insist that all bidders must pre-qualify through a process which vets the experience and drilling record of potential bidders. There is no such scheme in place for operations in Arctic Canada although the *CPRA* could easily accommodate such a requirement. It is true that the applicant for a drilling authorization (under the *Canada Oil and Gas Operations Act*, RSC 1985, c O-7) will face scrutiny before it can drill a well, but why not do a general assessment of suitability *before* a party acquires a land position. In this case the Canadian Press report in the Herald (*supra*) suggests that the successful bidder is little more than a corporate shell: "Franklin has two employees – CEO Paul Barrett and his wife. It has $200 in the bank and a net worth of minus $32,000." And LinkedIn UK suggests that Mr. Barrett is also the CEO of Arctic Energy and Minerals Ltd – the successful bidder on Beaufort blocks last year.

In effect, this decision to grant Franklin exploration rights over such large blocks of land is merely encouraging Franklin and those who will seek to emulate Franklin, to speculate with publicly owned resources. What Franklin must be hoping for is that there will be a significant uptick in Arctic exploration in the next five years. And if there is, we can bet that Franklin will farmout these exploration rights to a company with deeper pockets and hopefully a lot more experience. And then Franklin will go along for the ride. True, Franklin and Mr. Barrett may lose, the majors may have no interest in this block, but the price of admission to this speculative gambit is the 25% of the workbid that Franklin must put down. In this case that is $312, 772 per block. Is this really in the public interest?

What would make more sense?

Here are three small suggestions for improving the current system.

First, carry out a strategic environmental assessment (SEA) before making the significant decision to open up a new area to exploratory drilling. See Doelle et al, supra.

Second, develop and implement a scheme for the pre-qualification of bidders in an effort to ensure that those who are bidding on these blocks have the assets, the experience and the safety record to engage in this sort of activity.

And third, tighten up the bidding rules, either to change the standard practice to a (cash) bonus bidding system, or to require that a minimum work bid must at least cover the estimated cost of the exploratory well that must be drilled during the first period of the licence. And if that seems too draconian (since an explorer will want to know the results of a seismic survey before

deciding to spud a well) at the very least develop some rational minimum bid requirements that will serve to deter speculative entrants and will actually enhance the public interest in gaining knowledge about the potential oil and gas resources in the area (assuming of course that the SEA tells us that this is an acceptable type of activity in this particular area).