

CANADA, THE LAW OF THE SEA TREATY AND INTERNATIONAL PAYMENTS: WHERE WILL THE MONEY COME FROM?

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SUMMARY

Canada is a party to the United Nations Convention on the Law of the Sea, having ratified it in 2003. This Convention requires parties to it to make payments in respect of oil production on their continental shelves beyond 200 miles, to an international organization which is then tasked with distributing such payments to selected States parties to the Convention, taking into account the interests of the least-developed countries.^{*}

Canada has a number of offshore licenses in the area of the continental shelf to which these payments will apply. The amount of the payments is based on the total production at the site. After 12 years of production, the Convention stipulates that the amount of the payment is seven percent of production, and remains at that percentage for the rest of the producing life at the site.

It is anticipated that Canada may be the first state to be required to make these payments. The annual cost to Canada of this obligation will be in the millions of dollars.

At present Canada has no framework in place to source these funds. There is a well-developed royalty regime in the offshore, but it does not contemplate this substantial requirement. This paper discusses how this requirement developed in international law, the role of Canada in its development, and how it has come to be that there is no contemplation of this requirement in the current framework of Canadian law. The paper also discusses potential solutions.

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^{*} Infra fn 54. In Annex 6 of this report, Professor Frida Armas-Pfirter opines on "potential options on equitable distribution of payments and contributions." This paper includes commentary on the role of the Seabed Authority Council in recommending to the Seabed Authority Assembly rules, regulations and procedures on this distribution.

OVERVIEW

The Atlantic Ocean Canadian offshore area is approximately 1.1 million square miles. Worldwide, the broadest continental shelf area beyond 200 miles is to the east and southeast of the coast of the island of Newfoundland.¹ Oil and gas exploration has been taking place there since the 1960s.² Its regulation is complex. The legal framework is the result of three interrelated factors:

1. Canadian laws resulting from years of disagreement, court cases and political accommodation between the federal and provincial governments concerning ownership of seabed resources;³
2. Canadian international rights and obligations as reflected in the Law of the Sea Treaty (UNCLOS), to which Canada is a party;⁴
3. Canadian laws which implement portions of UNCLOS or otherwise extend Canadian laws to the offshore area.⁵

Exploration continues to take place well beyond 200 nautical miles (NM) from the east coast of Newfoundland & Labrador (NL). Recently Statoil and its co-venturer Husky Energy announced a significant hydrocarbon discovery in the Flemish Pass area approximately 300 miles from the coast in an area regulated by the Canada—Newfoundland and Labrador Offshore Petroleum Board (CNLOPB). Statoil estimated that this discovery is between 300 and 600 million barrels of recoverable oil. This is a very substantial find.⁶ If this field eventually becomes the location of a production facility, Article 82 of UNCLOS requires that Canada make annual payments or in-kind contributions, based on a percentage of production (starting at one percent after five years of production and levelling out at seven percent after 12 years) to an international body, which is then obliged to distribute these payments to UNCLOS States Parties based on equitable criteria, bearing in mind the needs of developing countries. Canada has not legislated in respect of this obligation. The in-kind contribution is probably not an option for Canada as Canadian law gives the holder of a production license title to the petroleum produced.⁷ The mechanics of on-site collection and transfer to a third party are not practical options in any event.

Canada is an economy driven by natural resources — onshore, in the oceans and on the oceans seabed and subsoil within its jurisdiction. This has always been a key element of Canadian foreign policy.

¹ Victor Prescott, “National Rights to Hydrocarbon Resources of the Continental Margin beyond 200 nautical miles,” in Blake et al, “Boundaries and Energy: Problems and Prospects,” *International Boundary Studies Series*, Ch. 4 at 60, Kluwer Law International, 1998; the Canadian submission to the Commission on the Limitations of the Continental Shelf in respect of the east coast offshore demonstrates that the area of continental shelf beyond 200 NM is at least another 200 NM. www.un.org/depts/los/clcs_new/submissions_files/submission_Can_70_2013.htm

² Fusco, “Offshore Oil: An overview of development in Newfoundland and Labrador,” in *Oil, Power and Dependency*. Memorial University (2007); D.G. Crosby, “Mineral Resource Activities in the Canadian Offshore,” (1970) 6 *Maritime Sediments* p. 30. This article contains a useful map showing the extent of federal oil and gas exploration permits in the Flemish Pass and Flemish Cap areas offshore Newfoundland; licenses in the 1960s were granted under the Canada Oil and Gas Land Regulations, C.R.C., c. 1518 (Published in 1961). These regulations were made pursuant to the *Territorial Lands Act*, S.C. 1950, c. 22 and the *Public Land Grants Act*, S.C. 1950, c. 19. The regulations apply to “Canada lands” which “includes land under water” (s. 2(1)(b)).

³ There is federal and provincial reciprocal legislation representing the agreement between federal and provincial interests. In this paper we refer only to the Newfoundland legislation (and not to the Nova Scotia versions), being the *Canada-Newfoundland Atlantic Accord Implementation Act*, S.C. 1987, c. 3 (the “Accord Act”). This is the federal law concerning the regulation of the Newfoundland offshore area.

⁴ 1833 U.N.T. S. 3, December 10.

⁵ *Oceans Act*, S.C. 1996, c. 31

⁶ www.statoil.com/en/newsandmedia/news/2013/pages/baydunord270813.aspx; the exploration license that eventually resulted in Statoil’s significant discovery license was issued in 1999. See www.nr.gov.nl.ca/nr/invest/cfb_nl99_1.pdf

⁷ The *Accord Act*, s. 80(1)(d) but note Part III of the royalty regulations, 2003 pursuant to the *Petroleum and Natural Gas Act* (R.S.N.L. 1990 Chapter P-10) which apply to the offshore and which contemplate royalties in kind in certain circumstances.

Striving to extend the breadth of this jurisdiction to encompass more resources has been a Canadian goal for generations.⁸

The potential inclusion of Article 82 obligations in the Canadian offshore regulatory framework is the subject of this paper. There are two issues for Canada. One is the manner in which Article 82 can be interpreted and applied. The second is the way in which the financial requirements of Article 82 can be funded by Canada. In order to frame discussion of these issues it is necessary to describe the overall structure of UNCLOS, the nature of the negotiations leading to its finalization, Canadian foreign policy objectives at the time, the way in which UNCLOS provisions balance the various interests at play in the uses of the oceans, coastal state rights in respect of the exploitation of seabed resources and the extent of these rights over continental shelf areas beyond 200 NM. It is also necessary to consider the royalty regime on the Canadian east coast and its history. This puts structure around the options which are available to Canada to generate the revenue necessary to fund the Article 82 payment requirements. This paper questions whether these payments might be derived from the resource operator, from Canada or Newfoundland and Labrador, or some combination of all of these.

UNCLOS

UNCLOS has been called the “Constitution of the Oceans,” first so-called by the UNCLOS Conference Chairman Tommy Koh of Singapore in a speech at the time of the adoption of the Convention. The Convention currently has 167 parties to it including Canada.⁹ UNCLOS entered into force in November 1994. Canada was an original signatory on December 10, 1982 and ratified¹⁰ on November 7, 2003 (entering into force 30 days later on December 7, 2003). UNCLOS represents the international consensus concerning the legal framework for the governance of the oceans. It was negotiated as a ‘package deal’ in which it was considered that nothing was agreed until everything was agreed.¹¹ Alan Beesley was Canadian Ambassador to the Conference, and chair of the Conference Drafting Committee. At a press briefing¹² in March 1980, he described a number of parts of this package that were of importance

⁸ B. Buszan, B. Johnson, M.W. Zacher, eds and D. Middlemis, “Canadian Foreign Policy and the Exploitation of the Seabed,” in Johnson and Zacher, *Canadian Foreign Policy and the Law of the Sea*, U.B.C. Press (1979) 1-51; P. Copes, “Canadian Fisheries Management Policy: International Dimensions,” in D. McRae and G. Monroe, *Canadian Oceans Policy, National Strategies and the New Law of the Sea*, U.B.C. Press (1989) 3-16.

⁹ www.un.org/depts/los/reference_files/chronological_lists_of_ratifications.htm.

¹⁰ The effect of ratification is to render a treaty an enforceable obligation as soon as the treaty comes into force, which in the case of UNCLOS had already occurred by the date Canada ratified. In order for UNCLOS or any of its provisions to become part of Canadian domestic law, they must be incorporated into a Canadian statute. Until that occurs, UNCLOS Treaty obligations *per se* are international obligations of the Canadian executive branch only, enforceable through the mechanisms of UNCLOS, Part XV. These are basic principles of Canadian constitutional law, see P. Hogg, *Constitutional Law of Canada* (15 edition) 2009 Carswell, Chapters 11 and 13; J. Currie, *Public International Law* (2d) 2008 Irwin; *Canada’s Approach to the Treaty-Making Process*, Library of Parliament Research Publications at <http://www.parl.gc.ca/content/lop/researchpublications/2008-45-e.htm>

¹¹ The package deal approach was a significant aspect of UNCLOS. Article 309 does not permit states to make reservations or exceptions to their acceptance of UNCLOS. Alan Beesley, Canadian Ambassador to the Conference and Chair of the Drafting Committee, introduced the Resolution at the UN calling for the Conference, said to have ‘laid the basis for the Conference’s understanding that its work was to constitute a “package deal.”’ R. Hage, “Canada and the Law of the Sea,” (1984) *Marine Policy* 2 at 4; A Beesley later describes this strategy in “The Negotiating Strategy of UNCLOS III: Developing and Developed Countries as partners – a pattern for future multi-lateral international conferences,” (1983) 46 *Law and Contemporary Problems* 183 at 185: “The concept was fundamental to the Conference from its outset.” See also Beesley, “Law of the Sea: Prospects for Success and Consequences of Failure,” in *Ocean Industry in Atlantic Canada, Proceedings of a Conference in Halifax* March 1980, at 101: “Nothing is settled until everything is settled”; Alan Boyle, “Further Developments of the Law of the Sea Convention: Mechanisms for Change,” (2005) *International and Comparative Law Quarterly* 563; H. Caminos and M. Molitor, “Progressive Development of International Law and the Package Deal,” (1985) 79 *American Journal of International Law* 871.

¹² http://library.ubc.ca/archives/_arch/beesley_j._alan.pdf in Box 3-4, Item 2.

to Canada. At this point the Conference was still ongoing and the ‘package’ had not been finalized, although Canada had already taken unilateral steps in respect of a number of these items:

- The 12-mile territorial sea;
- Rules for passage through international straits — the right of transit;
- Rights over anadromous fish species — salmon;
- The 200-mile limit;
- The limits of the continental shelf;
- Seabed mining production limits for nickel.

These goals, consistent with Canada’s objectives as a natural resources country at the Conference, were achieved. These successes have been described by Robert Hage¹³:

“Canada succeeded in achieving most of its objectives at the Conference: the 12-mile territorial sea; 200-mile exclusive economic zone; protection for Canadian salmon; sovereign rights over the greatest part of the continental shelf; enhanced jurisdiction for the prevention of marine pollution, including special measures for Arctic waters; and an equitable seabed-mining regime based on the principle of the “common heritage of mankind.” Canada also gained benefits it did not initially seek, such as protection for its land-based mining industry and a recognized role as a “pioneer” seabed-mining state. This success can largely be attributed to the pursuit of clearly and early defined goals; the multidisciplinary and consistently-led delegation; the ability to advance creative mechanisms to resolve problems (from the “Gentlemen’s Agreement” to the formation of the group of 12); and a willingness to form and participate actively in the functional interest groups.”

It is helpful to more fully describe the issues surrounding nickel production and the fishery to give a better sense of their importance to Canada.

With respect to the protection of the nickel industry, Canada was concerned that unregulated mining of seabed nodules from the ocean floor would result in a competitive disadvantage for Canadian nickel production and export.¹⁴ At the time Canada was the world’s largest producer and exporter of nickel. It therefore supported a production ceiling limitation for the production of nickel from seabed manganese nodules. This resulted in Article 151 of UNCLOS, which contains such a limitation.¹⁵ Speaking of this accomplishment Ambassador Beesley commented:¹⁶

“We have managed to achieve again the inclusion in the text of a provision called a nickel production ceiling which places a limit on the rate at which seabed mining can come on stream so that it will not suddenly arrive and displace the land-based producers.”

¹³ Supra, Note 10 at 15. Robert Hage was Alternate Representative for Canada to UNCLOS III and Head of the Law of the Sea and Arctic Affairs Section, Department of External Affairs, Ottawa.

¹⁴ L.L. Herman, “The Niceties of Nickel in Canada and the Production Ceiling Issue at the Law of the Sea Conference,” (2013) 6 *Syracuse Journal of International Law and Commerce* 265.

¹⁵ This limitation was eventually discarded in the Agreement relating to the Implementation of Part XI of UNCLOS executed in July 1994, due in part to the fact that since the signing of UNCLOS in 1982, a number of the developed states had not joined UNCLOS as it contained “a number of non-market policies including setting limits for seabed production,” S.W. Park, “Key Issues on the Commercial Development of Deep Seabed Mineral Resources,” in *Proceedings from the 2012 L.O.S.I Conference on Securing the Oceans for the Next Generation*.

¹⁶ Supra, note 13 at box 3-4, Item 1.

Canada's fisheries interests were of considerable importance.¹⁷ The protection of salmon was at "the forefront of Canadian concerns."¹⁸ The result of this concern was Article 66 concerning the rights of the state of origin over anadromous species. This Article set the stage for the later Pacific Salmon Treaty. Ambassador Beesley described this accomplishment:¹⁹

"It is a compromise that recognizes the interest of the state of origin. 'Interest' is the term used with respect to the management of salmon even beyond the coastal states 200-mile economic zone and even within the 200-mile economic zone of another state."

These two issues required intense effort on the part of Canada to secure the eventual favourable compromises reflected in UNCLOS. Insofar as reaching agreement on the maritime zones of the oceans, it was much easier going, so much so that as noted earlier Canada had already taken unilateral action respecting the 12-mile limit and the 200-mile EEZ.²⁰ In the result, UNCLOS defines the extent of the territorial sea (12 miles from the coast)²¹, exclusive economic zone (beyond 12 miles to 200 miles, EEZ)²² and the high seas (beyond 200 miles).²³ This action was consistent with an emerging international consensus on such claims.

The continental shelf (CS) is the seabed and subsoil of the submarine areas lying under the territorial sea and extending to the outer edge of the continental margin.²⁴ In many places the Canadian CS extends beyond 200 miles. The waters superjacent to the CS beyond 200 miles are the high seas. The ocean floor and subsoil beyond the CS is the 'Area'²⁵ which is beyond the limits of national jurisdiction.

The rights of a coastal state in respect of the CS are limited to sovereign rights to explore and exploit its natural, non-living resources, which include hydrocarbons and sedentary species (e.g., deep sea scallops and lobster). In the case of Canada, and other coastal states with wide continental shelves, some of the resources of the CS are found under the high seas beyond 200 NM. The Conference had many meetings and produced many drafts before agreement was reached on this definition of CS in Article 76. Key to this compromise was Article 82.

¹⁷ L.S. Parsons, "Management of Marine Fisheries in Canada," (1993) *Cdn. Bull. of Fisheries and Aquatic Sciences* 223; B. Caldwell, "The Pacific Salmon Treaty: a Brief Truce in the Canada/USA Pacific Salmon War," (1999) 57 *The Advocate*, Part 3(1).

¹⁸ T. McDorman, "The West Coast Salmon Dispute: A Canadian View of the Breakdown of the 1985 Treaty and the Transit License Measure," (1995) Loyola of Los Angeles, *International and Comparative Law Journal*, 477 at 479

¹⁹ Supra, note 13, Box 3-4, Item 2 at 3.

²⁰ *The Territorial Sea and Fishing Zones Act*, R.S.C., 1970 c. 68 which extended the territorial sea to 12 miles. In 1977 Canada declared a 200-mile fishing zone, in large measure to protect Canadian fishing interests from the incursion of foreign fishing fleets.

²¹ Article 3, Part II.

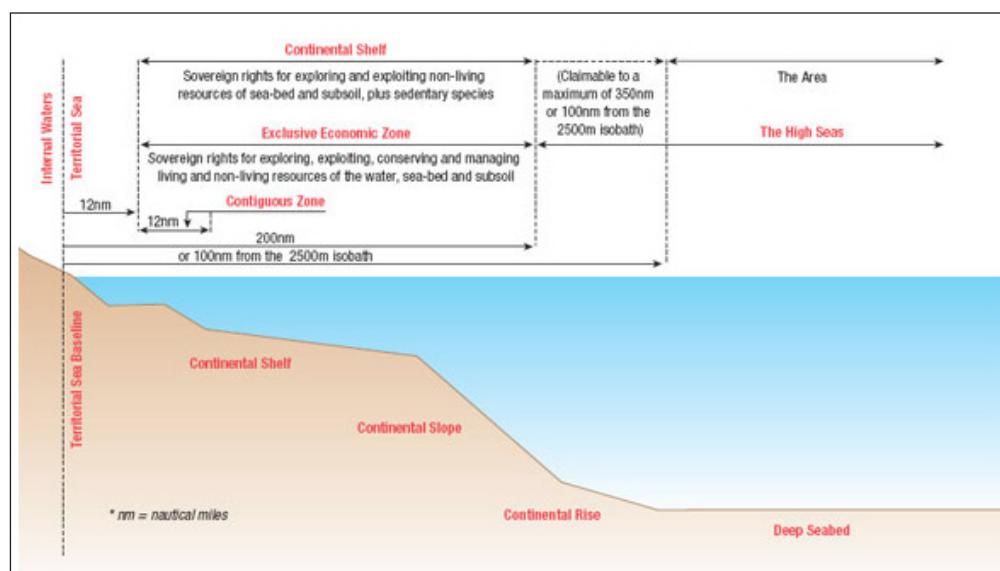
²² Article 57, Part V.

²³ Article 86, Part VII.

²⁴ Article 76 (or 200 NM if the CS does not extend to 200 NM) Part VI.

²⁵ Article 1, generally Part XI.

MARITIME ZONES AND CONTINENTAL SHELF AREAS



From: <http://www.dfo-mpo.gc.ca/oceans/canadasoceans-oceansducanada/marinezones-zonesmarines-eng.htm>

Seabed resource exploration has been a part of international law since at least 1958.²⁶ The provisions of UNCLOS continue that recognition. While the rights to explore for hydrocarbons on the CS do not affect the legal status of the waters above, UNCLOS contemplates that the exercise of these rights may result in interference with the rights of navigation in the waters above.²⁷ Specifically addressing the high seas area (the CS area of the seabed beyond 200 NM), UNCLOS recognises that states may engage in exploration-related activities but cautions that this must be done with “due regard” to the interests of states exercising their rights to freedom of the high seas.²⁸ The balancing of these rights is contemplated by UNCLOS, and the way in which these rights will be balanced will necessarily change over time. Within the EEZ the coastal state has a number of national rights that do not apply beyond 200 NM.²⁹

The sovereign right described in Article 76 to explore and exploit on the CS is twofold.³⁰ It is the exploration/exploitation right itself, and all rights necessary and connected to that right (including the exclusive right to conduct drilling operations) consistent with the balancing of ocean uses described in UNCLOS. Examples of this latter right are the authority to regulate the consequences of oil pollution

²⁶ Geneva Convention on the Continental Shelf, 499 U.N.T.S. 311. The concept of the extent of the continental shelf in this Convention was that it ran to the “limit of exploitability.” This concept was altered by UNCLOS to better define the geographic extent of the CS, so as to avoid the continuing extension of a CS based on technological advances; this was called “creeping territorialism.”

²⁷ Article 78 which provides that:
“2. The exercise of the rights of the coastal State over the continental shelf must not infringe or result in any unjustifiable interference with navigation and other rights and freedoms of other States as provided for in the Convention”.

²⁸ Article 87.

²⁹ Article 56 provides for coastal state management of the natural resources in the EEZ. It enables a coastal state, for instance, to manage its fisheries interests to the limit of the EEZ. Canada has exercised these rights for many years.

³⁰ The International Law Commission, created by the United Nations in 1947 (to advise and assist with the development and codification of international law matters), commented on the meaning of the rights given to “explore and exploit natural, non-living resources” in what is now UNCLOS Article 77 (*Oceans Act* s. 18) in its annual report to the UN:
“the text as now adopted leaves no doubt that the rights conferred upon the coastal state cover all rights necessary for and connected with the exploration and exploitation of the natural resources of the continental shelf. Such rights include jurisdiction in connection with the prevention and punishment of violations of the law” (emphasis added). A/CN.4/SER.A/1956/Add.1 at 297;

See also Natalie Klein, *Maritime Security and Law of the Sea*, Oxford U.P., 2011 at 99; Vella, “A New Advent for Renewable Offshore Resources,” in Gutierrez (ed), 210, *Serving the Role of International Maritime Law* 136 at 193.

caused by the exploration/exploitation activities of licensed offshore operators, the regulation of vessel traffic in the vicinity of production platforms and requirements concerning environmental protections in the area of a resource development.

These are the balances which UNCLOS creates in the uses of the oceans and its resources. This balance changes as the uses of the oceans develop.

CANADIAN OFFSHORE REGIME

Canada has implemented some aspects of UNCLOS by passing legislation consistent with it. In particular, the maritime zones defined in the *Oceans Act* are derived from the same zones specified in UNCLOS, and the nature of the rights to explore and/or exploit hydrocarbon resources of the CS are identical to the comparable Articles of UNCLOS.

Canada's east coast offshore regime is regulated by Offshore Petroleum Boards created by the Accord legislation. In the case of Newfoundland & Labrador the regulatory body is the CNLOPB, which fully occupies the regulatory space for the offshore oil and gas resources of the CS. The CNLOPB issues licenses for exploration and exploitation in the "offshore area"³¹ which extends to the outer edge of the continental margin. For many years, such licenses have been issued for areas of the CS beyond 200 miles;³² in the most recent round of calls for bids by the CNLOPB all the areas are located beyond 200 NM.³³ Currently all production licenses are in respect of projects on the CS within 200 NM.³⁴

Beyond granting licenses for exploration activity occurring on the CS beyond 200 NM, Canada has taken a number of legislative steps which serve to spread the protective umbrella of Canadian laws beyond 200 NM to the outer edge of the continental margin (the offshore area). The *Oceans Act* provides that federal laws apply to marine installations located on the CS and to any safety zones surrounding them.³⁵ In recognition of Canada's obligations to UNCLOS, these laws are required to be applied in a manner consistent with the rights of other countries under international law and in particular, rights in respect of freedom of navigation.³⁶

The *Criminal Code*³⁷ provides that offences committed on marine installations on the CS are deemed to have been committed in Canada. Rights of arrest, entry, search and seizure are extended to marine installations on the CS.

³¹ *Accord Act*, s. 2 defines "Offshore Area" as:

"those submarine areas lying seaward of the lower watermark of the Province and extending, at any location, as far as
b) where no line is prescribed at that location, the outer edge of the continental margin or a distance of 200 NM from the baselines from which the breadth of the territorial sea of Canada is measured, whichever is greater.

³² In the 1980s prior to the creation of the CNLOPB, licenses were issued pursuant to the *Canada Oil and Gas Act*, 1980-81-82-83, c. 81 permitting licenses to be issued in "Canada lands" which includes (1)(b):

"Those submarine areas common not within a province, adjacent to the coast of Canada and extending throughout the natural prolongation of the land territory of Canada to the outer edge of the continental margin..."

³³ NL 15-01 EN (Eastern Newfoundland Region) at <http://www.cnlopb.ca/activebids.shtml> In December 2014 the CNLOPB granted exploration rights in areas beyond 200 NM to Exxon, Suncor Energy and Conoco Phillips. The price to be paid for these areas (NL 13-01) was \$559,000,000. See at <http://www.cnlopb.ca/news/nr20141212.shtml>

³⁴ http://www.cnlopb.ca/land_infotables.shtml These are the licenses for Hibernia, Terra Nova, White Rose and North Amethyst. These production licenses cover an area of 46,759 hectares.

³⁵ In s. 20.

³⁶ In s. 20(2)(c).

³⁷ R.S.C. 1985, c. C-46 s.477.1 and .3.

While certain laws have effect through the full extent of the CS, it is nevertheless the case that various services provided by the Canadian government do not reach beyond the 200-mile limit of the EEZ, thereby somewhat limiting the reach of the Canadian umbrella to activities within 200 NM.

The Canadian Coast Guard provides many services in respect of waters “under Canadian jurisdiction,”³⁸ including Notices to Mariners, hydrographic services maps, vessel patrols and others. At present these services are generally restricted to within 200 NM. The mandate of the East Coast Response Corporation (Oil Spill Response), created by the *Canada Shipping Act*³⁹ is limited to areas within 200 NM. It is odd that Canada has issued hydrocarbon exploration licenses for areas beyond the 200 NM limit of the CS, but has no authorized oil spill response capability for such locations.

An oil and gas facility on the CS beyond 200 NM is on the “high seas,” located in international waters and subject to the navigation of foreign fishing vessels, some of which will be engaged in bottom trawling. There is currently no effective method contemplated by the Canadian offshore regime to monitor such activities in the vicinity of an oil and gas facility on the high seas.⁴⁰ As the map below demonstrates, Area 3M of the NAFO Management Area is in the area of the Flemish Cap, beyond 200 miles and an area licensed by the CNLOPB. Statoil’s significant discovery is in this area.



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³⁸ See <http://www.notmar.gc.ca/eng/services/annual/annual-notices-to-mariners-eng.pdf> at A20. This is a bulletin concerning the safety of offshore exploration and exploitation vessels with respect to vessels “in waters under Canadian jurisdiction.” <http://www.imo.org/OurWork/Safety/RadioCommunicationsAndSearchAndRescue/RadioCommunications/Page/Default.aspx> It is also a common complaint from offshore facilities that there is a lack of response when vessels in the vicinity are called on the emergency radio channel.

³⁹ S.C. 2001, c. 26. The ECRC was created by Part 8 of the Act which addresses pollution prevention and response. s. 166(1) restricts application of this part to Canadian waters or waters in the exclusive economic zone. The ECRC itself is a response organization created pursuant to s.169.

⁴⁰ There is an ongoing effort to create a regulatory framework for fishing vessels operating beyond 200 NM. This is being undertaken by the International Maritime Organization and the Food and Agricultural Organization of the United Nations. See <http://www.fao.org/docrep/003/x9656e/x9656e01.htm> Interestingly, Portugal has declared a “no bottom trawling zone” for ships flying its flag, in waters beyond the 200-mile limit. See at reference <https://dre.pt/application/dir/pftlsdip/2014/05/10200/0297702979.pdf>.

Communicating with vessels in the vicinity of a project location on the high seas can be an issue.⁴¹ Activities licensed by the CNLOPB on the CS within 200 NM have the full benefit of the offshore regime protective umbrella, consistent with the jurisdiction exercised by Canada within the EEZ. Licensed activities occurring on the CS beyond 200 NM do not have the benefit of the full umbrella.⁴² A recent initiative of the UN to begin negotiations on a new UNCLOS-related agreement for the conservation of areas beyond national jurisdiction could arguably have an impact on operations on the continental shelf beyond 200 NM.

ARTICLE 82: HISTORY AND RATIONALE

As noted earlier, Canada had been issuing licenses for activities offshore for many years in areas beyond 200 NM.⁴³ This activity had been supported in international law by the Geneva Convention on the Continental Shelf and also the 1969 decision of the International Court of Justice in the North Sea Continental Shelf cases,⁴⁴ which confirmed that the rights of a coastal state in respect of its exploration and exploitation rights for natural resources on its continental shelf are “inherent rights.”⁴⁵

At the time of the UNCLOS Conference, the definition of the continental shelf (specified in Article 1 of the Geneva Convention on the Continental Shelf, 1958, *supra* fn. 27 had reference to the “limits of exploitability.” As technology developed, it became recognized that “exploitability” was too fluid a limit and the geographical extent of the continental shelf became a fundamental piece of the UNCLOS Conference proceedings.⁴⁶ Having moved to a continental shelf defined by its geographical extent, Article 82 became an important factor in reaching agreement on the extent of the continental shelf to include the entire continental margin.

Article 82 is very much a result of the balancing of interests that took place during the UNCLOS Conference.⁴⁷ The extent of a state’s CS was a very live issue. Article 76, which delineates the extent of the CS, (and which is reflected in Section 17 of the *Oceans Act*) defines it, where applicable, as extending to the outer edge of the continental margin (the offshore area administered by the CNLOPB). There was resistance to this broad definition during the UNCLOS Conference for a number of reasons. States that did not have broad continental shelves, who were otherwise geographically compromised, or were simply developing states, were not in favour of a CS that stretched beyond 200 NM. The proposed Article 76 was seen as a potential reduction of what would otherwise be part of the “Area” (the seabed

⁴¹ See <http://www.imo.org/OurWork/Safety/RadioCommunicationsAndSearchAndRescue/RadioCommunications/Page/Default.aspx> It is also a common complaint from offshore facilities that there is a lack of response when vessels in the vicinity are called on the emergency radio channel; see also Kashubsky and Morrison, “Security of Offshore Oil and Gas Facilities: Exclusion Zones and Ship’s Routing,” (2013) *Australian Journal of Maritime and Ocean Affairs* 1, at 3.

⁴² This lack of full benefit has created some issues. See <http://www.thetelegram.com/Opinion/Letter%20to%20editor/2014-08-19/article-3838838/cnlopb-not-helping-nafo-efforts/1>.

⁴³ Note 1 and 29.

⁴⁴ North Sea Continental Shelf Judgements, ICJ Reports 1969, p. 3; Geneva Convention, *Supra*, Note 26.

⁴⁵ *Ibid* p. 42.

⁴⁶ Churchill and Lowe, *The Law of the Sea* (3d), 1999 at 143-144.

⁴⁷ Satya. N. Nandan and Shabtai Rosenne, Vol. eds., *UNCLOS 1982: A commentary*, Vol. II (Dordrecht: Martinus Nijoff Publishers 1993), “Commentary on Part VI, Article 82,” at 930-947; Aldo Chircop and Bruce Marchand, “International Royalty and Continental Shelf Limits: Emerging Issues for the Canadian Offshore,” (2003) 26 *Dal. L.J.* 273 at 283 – 294.

and its resources beyond national jurisdiction), the resources of which were to be vested in mankind as a whole and considered to form the Common Heritage of Mankind (CHM).⁴⁸

The resources in the Area are regulated by the International Seabed Authority (ISA), an international organization created by UNCLOS. It is the responsibility of the ISA to manage these resources on behalf of mankind as a whole. Currently the ISA is developing the various frameworks necessary to manage the nascent seabed mining industry in the Area.⁴⁹ The ISA in effect is the body responsible for caring for the largest commons in the world: the seabed and its non-living resources beyond national jurisdiction.

The Article 82 compromise permitted the broad definition of the CS in Article 76 to remain, but required payments or contributions in kind from a coastal state to the international community, should that state benefit from resource production on its CS beyond 200 NM. In that way, UNCLOS balanced the CS entitlement of coastal states to resource exploitation with the rights of other states to share in the resource benefits of what would otherwise have been the seabed and subsoil of the Area. Article 82 is the only place in UNCLOS in which there is a direct incursion into space within national jurisdiction. The sharing of revenues mandated by Article 82 is an extension of the CHM principle.⁵⁰

The compromise represented by Articles 76 and 82 is frequently referred to as a ‘quid pro quo.’⁵¹ The states with extensive continental shelf areas maintained their rights to a CS beyond 200 miles in return for revenue-sharing where production took place on that portion of the CS. Canada played a significant role in fashioning this result.

If the UNCLOS conference had failed, Canada would have likely continued to issue offshore licenses for areas beyond 200 NM and would not have incurred the revenue-sharing obligations of Article 82. In that sense Article 82 was on the loss side of the UNCLOS balance for Canada, for the reasons described by Hage⁵² as potentially resulting “in large financial outlays” (revenue-sharing). This premonition is now arguably the situation in which Canada finds itself.

⁴⁸ The CHM is a driving force of UNCLOS. Article 136 confirms its status with regard to the Area: “the Area and its resources are the common heritage of mankind.” Article 311(6) requires states to not become parties to agreements in derogation of the principle contained in Article 136. Generally see Satya N. Nandan, Michael Lodge and Shabtai Rosenne, “The Development of the Regime for Deep Seabed Mining,” *Commentary on the 1982 United Nations Convention on Law of the Sea* Vol. VI Introduction, (2002) Kluwer; David M. Ong, “A Legal Regime for the Outer Continental Shelf, an Inquiry as to the Rights and Duties of Coastal States within the Outer Continental Shelf,” www.iho.int/ntg_docs/com_wg/ablos.../PAPER7-4.pdf reference at 3.

⁴⁹ “Developing a Regulatory Framework for Mineral Exploitation in the Area, a Discussion Paper on the Development and Implementation of a Payment Mechanism in the Area,” www.isa.org/jm/news/isa-issues-discussion-paper-development-financial-terms

⁵⁰ Helmut Tuerk, *Reflections on the Contemporary Law of the Sea* (2012), Chapter 3, M. Nijhoff at p. 40; Michael Lodge, *Infra*, Note 57 at 332-333.

⁵¹ International Seabed Authority, “Non-Living Resources of the Continental Shelf Beyond 200 Nautical Miles: Speculations on the Implementation of Article 82 of the United Nations Convention on the Law of the Sea,” *Technical Study* No. 5 (Kingston IASW 2010) at p.; see also *Technical Study* 4 at fn. 57 at p. xi.

⁵² Hage, *Supra*, Note 10 at 15.

ARTICLE 82: SUBSTANCE

Article 82

Payments and contributions with respect to the exploitation of the continental shelf beyond 200 nautical miles

1. The coastal State shall make payments or contributions in kind in respect of the exploitation of the non-living resources of the continental shelf beyond 200 nautical miles from the baselines from which the breadth of the territorial sea is measured.
2. The payments and contributions shall be made annually with respect to all production at a site after the first five years of production at that site. For the sixth year, the rate of payment or contribution shall be 1 per cent of the value or volume of production at the site. The rate shall increase by 1 per cent for each subsequent year until the twelfth year and shall remain at 7 per cent thereafter. Production does not include resources used in connection with exploitation.
3. A developing State which is a net importer of a mineral resource produced from its continental shelf is exempt from making such payments or contributions in respect of that mineral resource.
4. The payments or contributions shall be made through the Authority, which shall distribute them to States Parties to this Convention, on the basis of equitable sharing criteria, taking into account the interests and needs of developing States, particularly the least developed and the land-locked among them.

The ISA, in 2012, conducted a workshop to consider implementation issues concerning Article 82. In describing the terminology used, a meeting of experts convened by the ISA noted:⁵³

It is important to appreciate that these terms were employed in Article 82 in order to secure the compromise needed, functioning more as instruments of compromise than terms of art. Each term requires individual clarification with reference to the use of other terms, to correctly and fairly reflect the intention behind the whole provision and in the context of the Convention.

It has also been noted that Article 82 “suffers from generality, lack of precision and ambiguity,”⁵⁴ exactly what you would strive to avoid in the drafting of a statute.

The heart of Article 82 for a coastal state is the obligations set out in 82(2). Ambiguous as they are and absent any experience from other states to rely on, it will be the responsibility of the first implementing states to give these terms meaning. It may well be that the first state to apply Article 82 will be Canada. What material is there to assist in this interpretation?

Treaty interpretation permits reference to the *Travaux Préparatoires* as an aid to ascertaining the meaning of a treaty. This material includes official documents recording the negotiations, drafting

⁵³ International Seabed Authority, “Implementation of Article 82 of the United Nations Convention on the Law of the Sea,” *ISA Technical Study* 12 (Kingston ISA, 2012 at 20).

⁵⁴ Chircop, “International Royalty and Continental Shelf Limits: Emerging Issues for the Canadian Offshore,” (2003) 26 *Dalhousie Law Journal* 273 at 294.

and discussions during the process of treaty creation.⁵⁵ In the case of Article 82, in addition to this material, there are scholarly commentaries which rely on the Travaux, and a number of ISA publications discussing key phrases in the Article. The following attributions of meaning to these phrases draw on the available literature.

- All Production⁵⁶

The consensus is that this means “gross” rather than “net.” During the UNCLOS Conference negotiations respecting Article 82, a working paper to characterize “all production” as net was not supported. It was thought that gross was the easier solution and avoided varieties of accounting systems. It was concluded that “fair market value at the wellhead” is what is meant by “all production.”

- The rate of payment or contribution is based on a percentage of the “value or volume” of all production.⁵⁷

This phrase links payment and contribution with value and volume. It is directly linked to the meaning of “all production.” This linkage supports value being determined as that at the wellhead. This interpretation permits fulfillment of the ‘payment’ or ‘contribution’ obligation by reference to the same qualifier, i.e., gross. It was contemplated that value and volume calculations should produce the same result.

- All production “at a site.”⁵⁸

It was recognized that “site” is quite ambiguous and can have a different meaning depending on the nature of the resource. It was considered best to leave this definition to the state implementing Article 82

- For purposes of calculating the payment or contribution, production does not include “resources used in connection with exploitation.”⁵⁹

This is a phrase replete with ambiguity. It is very important however as, depending on how it is applied, it may limit deductions from gross production, or the value of gross production to physical resources used in the production process, or it may contemplate the deduction of a whole range of financial or other resources necessarily spent to achieve production. The literature leans in favour of the ‘resources’ being restricted to physical elements used in production, such as flaring or gas used for reinjection.

⁵⁵ Martin Ris, “Treaty Interpretation and ICJ Resource to Travaux Préparatoires: Towards a Proposed Amendment of Articles 31 and 32 of the Vienna Convention on the Law of Treaties,” 14 B.C. *Int'l & Comp. L. Rev.* 111 (1991); the Supreme Court of Canada has agreed with this interpretive methodology in *Pushpanathan v. Canada (Minister of Citizenship and Immigration)* (1998) 160 D.O.R. (4th) 193; *Canada v. Ward*, [1993] 2 S.C.R. 689.

⁵⁶ International Law Association, *Third Report of the International Committee on Legal Issues of the Outer Continental Shelf* (2008) Rio De Janeiro, p. 4, Conclusion 2 <http://www.ila-hg.org/en/committees/index.cfm/cid/33>; M. Lodge, “The International Seabed Authority and Article 82 of the United Nations Convention on the Law of the Sea,” (2006) 21 *I.J.M.C.L.* 323 at 328; International Seabed Authority, “Issues Associated with the Implementation of Article 82 of the United Nations Convention on the Law of the Sea,” *Technical Study IV* (Kingston IAS 2009) at 33-34; A. Chircop, “International Royalty and Continental Shelf Limits: Emerging Issues for the Canadian Offshore,” (2003) 26 *Dalhousie Law Journal* 273 at 297; International Seabed Authority, “Implementation of Article 82 of the United Nations Convention on the Law of the Sea,” *ISA Technical Study 12* (Kingston ISA, 2012) at 20.

⁵⁷ Chircop, *ibid* at 297; Lodge, *ibid* at 328; ISA Study 12, *ibid* at 21; ISA Study 4, *ibid* at 33.

⁵⁸ ISA Study 12, *ibid* at 21.

⁵⁹ ILA Report, *ibid* at 8; Lodge, *ibid* at 329; Chircop, *ibid* at 296.

- “Payments and contributions shall be made annually.”⁶⁰

This could mean calendar year, financial year, or year of production. It is also possible that the value to be attributed may fluctuate during the course of a year. The timing of payments might affect the value.

- Payments are not required until the sixth year of production.⁶¹

The five-year grace period was thought to represent a reasonable time, during which the operator would be able to recover development costs. This was concluded at a time when wells were in much shallower water and closer to shore than is the case in 2015.

Canada is a party to the Vienna Convention on the Law of Treaties,⁶² which directs that “a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”⁶³ The Supreme Court of Canada has applied this rule⁶⁴ of treaty interpretation on a number of occasions. UNCLOS also requires that the state exercise good faith in fulfilling its UNCLOS obligations in a manner which would not “constitute an abuse of right.”⁶⁵

Having considered the manner in which the obligation of Canada to make a payment developed in international law, we now move to discuss the domestic context and note the absence of substantive references to this obligation in the Canadian domestic framework.

THE NL OFFSHORE ROYALTY REGIMES

The governments of Canada and Newfoundland and Labrador signed the Atlantic Accord Memorandum of Agreement in February 1985 (the “Memorandum”⁶⁶). Legislation giving effect to the Memorandum was subsequently passed by both governments.⁶⁷

The Memorandum “continues to play a role in the interpretation of the *Accord Acts*.”⁶⁸ In the context of the present royalty structure in NL, the Memorandum provides some useful context:

- s. 2 The purposes of this Accord are:
- (a) to provide for the development of oil and gas resources offshore Newfoundland for the benefit of Canada as a whole and Newfoundland and Labrador in particular;

⁶⁰ Lodge, *ibid* at 326; ISA Study 12, *ibid* at 22.

⁶¹ The Hibernia Field had first oil in 1997 and paid out in June 2009. Terra Nova had first oil in 2002 and first paid out in 2005, thereafter slipping back to gross royalty and resuming net royalty in 2007. The White Rose field had first oil in 2005 and full pay out in 2008.

⁶² *The Vienna Convention on the Law of Treaties*, Can. T.S. 1980 No. 37.

⁶³ *Ibid*, Article 31.

⁶⁴ Canada’s (Attorney General) v. Ward (1993) 2 S.C.R. 689; Pushpanathan v. Canada (Minister of Citizenship and Immigration), [1998] 1 S.C.R. 982.

⁶⁵ *Supra*, Note 3, Article 300. This Article has been considered by the International Tribunal for the Law of the Sea (ITLOS) in the M/V “VIRGINIA G” case (2014) case 19. While holding that the Article should be given a “wide and generous interpretation” (paragraph 65), the Court commented that it would be necessary to “specify the concrete obligations and rights under the Convention, with reference to a particular article, that may not have been fulfilled by respondent in good faith or were exercised in a manner which constituted an abuse of right” (para. 399).

⁶⁶ Available at www.servicenl.gov.nl.ca/printer/publications/aa_-MOU.PDF

⁶⁷ *Supra*, Note 2.

⁶⁸ Shawn Denstedt & R.J. (Jack) Thrasher, “The Accord Acts 20 Years Later,” (2007) 30 *Dal L.J.* 287 at 289.

...

(c) to recognize the right of Newfoundland and Labrador to be the principal beneficiary of the oil and gas resources off its shores, consistent with the requirement for a strong and united Canada;

...

(e) to provide that the Government of Newfoundland and Labrador can establish and collect resource revenues as if these resources were on land, within the Province.

s. 36 The principles of revenue sharing between Canada and Newfoundland with respect to revenue from petroleum-related activities in the offshore area shall be the same as those which exist between the Government of Canada and other hydrocarbon producing provinces with respect to revenue from petroleum-related activities on land. The federal legislation implementing the Accord, therefore, will permit the Government of Newfoundland and Labrador to establish and collect resource revenues and provincial taxes of general application as if these petroleum-related activities were on land within the province, through incorporation by reference of Newfoundland laws (as amended from time to time), or through appropriate legislative mechanisms.

The *Accord Act* created joint federal-provincial management of the offshore. This regime requires inter-governmental consultation on many fundamental issues related to the conduct of the offshore⁶⁹ industry.

However, in the case of calculation and structure of royalties, the government of Canada has played no active part. It was noted, perhaps not with Article 82 in mind, in 2001:

“An interest holder of a lease in the offshore area is confronted with the unfortunate circumstance that the Government of Canada has abandoned the legislative and regulatory field regarding the offshore royalty. As it is not involved in the negotiation and execution of royalty agreements, the current constitutional, legislative and regulatory solutions are problematic.”⁷⁰

Consequently there is no federal presence in the royalty arrangements for the NL offshore. The parties at the table are the government of NL and the representatives of the license holder.

The absence of the government of Canada at the NL royalty table is due to the federal- provincial agreements reflected in the Memorandum and the *Accord Act*, which requires all payments to be made to the federal government and then transferred to the government of NL..

If the government of Canada were to seek to recover the Article 80(2) royalty payments from an operator, it would be necessary to amend the existing legislation. The *Accord Act* creates the mechanism by which offshore royalties are deposited in the “Newfoundland Offshore Petroleum Resource Revenue Fund.” The Act then goes on to require that all monies in this fund be paid to Newfoundland and Labrador.⁷¹

The various royalty regimes applicable to the NL offshore have been described elsewhere in detail, most recently by Jack Thrasher and Simon Baines.⁷² The authors conclude that there are six separate royalty regimes applicable. In summary, they are:

⁶⁹ *Supra*, Note 4 s. 31.

⁷⁰ Alan T. Pettie, “Are Royalty Agreements Required for Canada East Coast Offshore Oil and Gas,” (2001) 24 *Dal L.J.* 151 at 213.

⁷¹ s. 214 (2)(b) *Accord Act*.

⁷² R.J. (Jack) Thrasher and Simon Baines, “Developments in Newfoundland and Labrador Offshore Royalties, from Hibernia to Hebron and Back,” (2014) *Dal L.J.* 33

1. A private contract regime for the Hibernia field;
2. The oil royalty regulations in respect of certain aspects of Hibernia;
3. For Terra Nova, the generic royalty regulations;⁷³
4. For White Rose, the generic royalty regulations;
5. For Hebron, the combination of the generic royalty regulations and a project-specific agreement;
6. For a portion of the Hibernia southern extension, an agreement pursuant to the *Petroleum and Natural Gas Act* which supersedes the generic royalty regulations.

The royalties contained in these various regulations and agreements are complex and complicated. These royalty agreements are either generic or specific and subject to negotiation, and potentially a combination of both. This further complicates the implementation of Article 82, as each royalty structure presents its own unique aspect. For present purposes, and to situate this royalty structure in the context of Article 82, it is sufficient to note a number of the concepts that form part of the NL royalty framework:

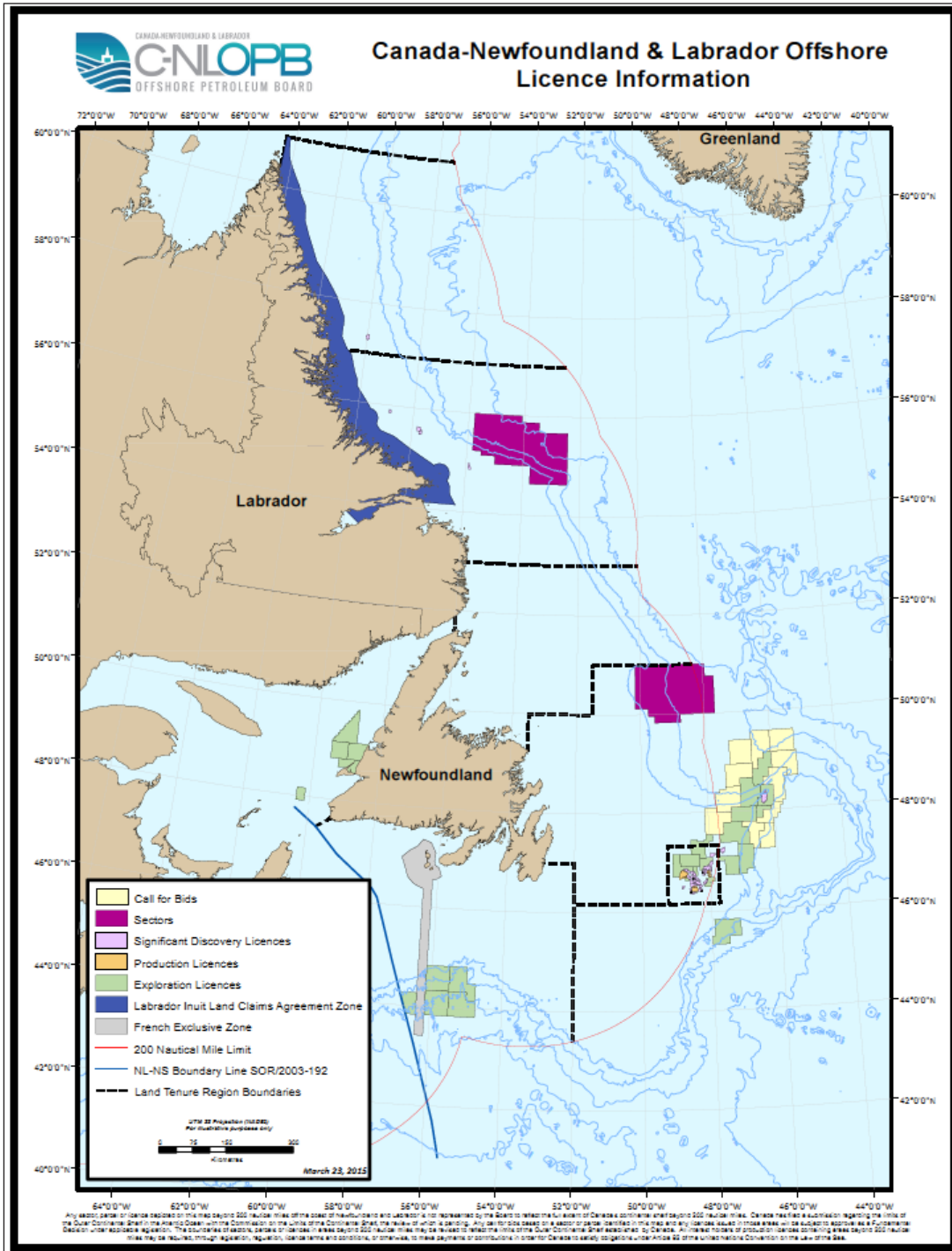
- a) Gross revenue which may include some deductions including transportation costs;
- b) Net revenue which includes many deductions;
- c) Royalty payments based on monthly calculations;
- d) Payment based on an interest holder's participation in an offshore lease;
- e) Liability for royalty payments to coincide with commencement of production.

In summary, the NL royalty regime contains elements of statute, regulation and private contract. It has been created without federal involvement and does not consider the possibility of Article 82 implementation. The generic royalty regulations apply to the entire offshore area, within and beyond 200 NM, and they make no mention of any Article 82 issues. These regulations were brought into effect by Newfoundland and Labrador in order to resolve disputes concerning the royalty regime for Terra Nova. They were intended to apply to Terra Nova and all projects subsequent to Hibernia.⁷⁴

⁷³ R.J. (Jack) Thrasher, "Newfoundland Generic Royalty Regime," (2003) 26 *Dal L.J.* 365

⁷⁴ An explanation concerning these regulations can be found in *Thrasher, Supra Note 73 at 38-39.*

OFFSHORE NL LICENSE INFORMATION MARCH 2015



From: <http://www.cnlopb.ca/maps/nlol.pdf>

Before considering the two main issues faced by Canada with respect to Article 82, some further background describing how Canada has approached Article 82 to date is instructive.

Canada seems to have effectively ignored Article 82, notwithstanding being an original signatory to UNCLOS, ratifying it in 2003, being a country heavily involved in the Article 82 compromise and having issued offshore exploration/exploitation licenses in areas where production will result in Article 82 obligations.

It was not until 2013 that the CNLOPB calls for bids contained a reference to Article 82. Until then, there had been no official notice in Canada that there may be a revenue-sharing obligation that may be satisfied through the introduction of direct payments from offshore producers on the continental shelf beyond 200 NM. As noted, this is notwithstanding exploration licenses having been issued for areas beyond 200 NM for many years. The current notice provides⁷⁵:

“The Board informs prospective bidders for these parcels, which are entirely or partially beyond Canada’s 200-nautical mile zone, that it has been advised by the Government of Canada that, in order to meet obligations arising pursuant to Article 82 of the United Nations Convention on the Law of the Sea, additional terms and conditions may be applied through legislation, regulations, amendments to licenses or otherwise.”

The original exploration license granted to Statoil which has given rise to a significant discovery was granted in 1999. There is no mention in the bid materials of any potential requirements of UNCLOS.⁷⁶ This may be explainable by the fact that Canada did not ratify UNCLOS until 2003. However, this lack of notice applies to all exploration licenses granted until 2013.

Other countries have been more attentive to Article 82. The *Continental Shelf Act* 1964⁷⁷ of New Zealand contains a section dealing with Article 82.⁷⁸ It refers to royalties, and directs the relevant Minister to have regard to Article 82 and further provides that the Crown will make all payments required by Article 82. This insertion into the *Continental Shelf Act* took place on August 1, 1996; New Zealand ratified UNCLOS on August 18, 1996. Currently in New Zealand, permits granted in respect of the continental shelf beyond 200 NM are solely for prospecting. These permits do not allow for drilling or production and consequently no royalty requirements are included in the permits.

Norway, in its announcements of offshore licensing rounds, alerts bidders that they may be required to cover an Article 82 expense, and then deduct it from their taxes: “the licensee may be required to cover this expense. In this case, the cost can be deducted under the Petroleum Taxation.”⁷⁹

Even though the United States is not a party to UNCLOS, it has for many years included a stipulation in its BOEM Lease Stipulations concerning Article 82. The stipulation outlines the way in which, if the US becomes a party to UNCLOS, the Article 82 obligation will be calculated, including addressing some of the ambiguities⁸⁰ such as the meaning of “site” and “years of production.”

The ISA has commented on the necessity of planning for the implementation of Article 82 by coastal states:⁸¹

“This long-term forecast is essential. As has been seen, licenses or leases for the exploration and development of offshore non-living resources have a long-term duration which can span decades.”

⁷⁵ www.cnlopb.ca/exploration/issuance.php#bids-active:__call_for_bidsNL15-01ENat3.1

⁷⁶ www.nr.gov.nl.ca/nr/invest/cfb_NL99_1.pdf

⁷⁷ *Continental Shelf Act* 1964, Public Act in No. 28.

⁷⁸ s. 5A was inserted into the *Continental Shelf Act* by Section 4 of the *Continental Shelf Amendment Act* of 1996.

⁷⁹ www.npd.no/Global/engelsk/2-Topics/%5bLicence-awards%5d/23-round/Invitation2015.pdf at 4(c). Norway commenced licensing blocks beyond 200 NM in 2010 in the Voring Plateau. See www.regjeringen.no/Globalassets/upload/oed/petroleumsmeldingen_2011/oversettelse/2011-06_white-paper-on-petro-activities.pdf at p. 110.

⁸⁰ www.boem.gov/Proposed-NOS-235-Package p. 45.

⁸¹ *Supra* Note 57, ISA Study No. 4 at 49.

The ISA also notes⁸² that long-term planning may allow for the producer to focus on recovery of costs during the five-year grace period before the regime comes into effect.

The academic commentary has also focused on this point, i.e., planning for offshore oil and gas is a long-term commitment. For example:⁸³

“The fact that offshore fiscal regimes tend to be negotiated well ahead of actual production, along with a desire to avoid potential domestic discord, indicates some urgency for broad margin states that are already licensing offshore activities on the extended shelf.”

This comment was made in 2004 and might have served as a wakeup call to Canada to begin the process of implementing regimes to give effect to Article 82.

ARTICLE 82 - THE INTERNATIONAL OBLIGATION

In giving meaning to the key phrases of Article 82, Canada has considerable interpretative latitude. There is no precedent from another country to draw upon (although the interpretations in the US BOEM leases are instructive) and the ISA has not yet produced a glossary of terms to assist coastal states. The standard for Canada to meet is that of good faith, presumably an easy standard to attain.

In attributing meaning however, Canada will need to be mindful of the impact these decisions will have on the way it approaches the domestic funding of its international obligations. Some examples illustrate the point:

1. Choosing “net revenue” as opposed to “gross” as the meaning for “all production” will significantly affect the amount of money needed to fund the obligation. Examples of common deductions from production can be seen throughout the existing royalty regimes in place in Canada;
2. Choosing the criteria for the deductibility of “resources used in production” may similarly have an effect on monies required;
3. Deciding that a “site” is a licensed area as opposed to a “well” will affect what costs are deducted for the five-year grace period and when that five-year grace period begins and ends. Many producing facilities in operation are sourced in a staggered fashion from different wells brought on at different times;
4. The timing of the commencement of “annually” will also have an effect.

It has been suggested that the monies generated by Article 82 are in some way an extension of the Common Heritage of Mankind principle.⁸⁴ The argument is that if it had not been for the Article 82 compromise, the seabed of a Continental Shelf beyond 200 NM would have been part of the Area. If this argument is accepted, it is relevant for Canada to consider the manner in which the ISA is approaching the future financial regime applicable to the deep sea mining industry in the Area. The ISA is directed by Article 137(2) to administer the resources of the Area on behalf of “mankind as a whole.” The ISA has stated that any royalty payment in respect of such a mineral resource in the Area should be based

⁸² *Ibid* at 50.

⁸³ Aldo Chircop, “Operationalizing Article 82 of the United Nations Convention on the Law of the Sea: A new Role for the International Sea Bed Authority?” in *Ocean Yearbook* 18 (2004) University of Chicago Press at 395.

⁸⁴ *Tuerk, Supra Note 51 at p. 40*, commenting on Article 82 as “Part and parcel of the common heritage concept.”

on its “intrinsic value.”⁸⁵ This approach to maximizing return to the ISA on behalf of the CHM is also reflected in the comments of the ISA with respect to returns as they might interact with domestic tax regimes.⁸⁶ Though the ISA does not set the parameters for Article 82 payments, it may be prudent for Canada to consider the ISA approach to deep sea mining when forming a view as to the good faith interpretation of Article 82. It is also worth noting the attitude of the ISA to the purpose of Article 82. Michael Lodge has suggested that:

“Article 82 has been described as a unique provision in international law. There are very few, if any, similar provisions in any other legal instrument which set out a legal obligation designed to address inequity in a practical way.”⁸⁷

FUNDING ARTICLE 82 FROM OFFSHORE ROYALTIES?

Like most things in life, determining who is to pay is where the rubber hits the road. In this case, both the federal government and the government of NL have made comments as to who should be responsible for Article 82 payments. In 2014, a spokesman for the Department of Foreign Affairs indicated that the method of implementation of Article 82 had not been determined “however, Article 82 payments should be sourced from the benefits stemming from the associated offshore activity.”⁸⁸ The Natural Resources Minister of NL stated at that time that, “the operation of the regime, who would make payments or contributions, are still under development by Canada (as a coastal state).”⁸⁹

This section of the paper asks a number of questions concerning which of the stakeholders might reasonably be expected to pay for the obligation of Canada pursuant to Article 82. It is taken as a given that the normal royalty will be payable by an operator in respect of operations on the continental shelf beyond 200 NM. The issue is whether the operator can be expected to pay more than operators within 200 NM simply because of its location and because of the treaty obligation of Canada to make a payment to the ISA.

When this issue surfaced in Canada in 2004, the then-premier of NL, Danny Williams, had no difficulty in stating that this issue was up to Ottawa to address:⁹⁰

“They created a problem for us, and they have also created a problem for industry in the province... so if anything has to be paid to any participating countries, then in fact that has to be borne by the federal government, certainly not us.”

Throughout this backing and forth between the federal government and the government of NL, there has been no comment from any potential oil company operator.

⁸⁵ “Discussion Paper on the Development and Implementation of a Payment Mechanism in the Area for Consideration by Members of the Authority and all Stakeholders,” ISA 2015, p. 20. At www.ISA.org/jm/news/ISA-issues-discussion-paper-development-financial-TER

⁸⁶ *Ibid.*, p.25: “Too lenient a financial model in the Area could shift profits toward a national taxing regime at the expense of the CHM. This would clearly undermine the Authority’s ability to optimize revenues for the CHM.”

⁸⁷ Michael W. Lodge, “The Deep Sea Bed,” Chapter 11 in Rothwell (ed.), *Oxford Handbook of International Law of the Sea* at p. 251 (Oxford, 2015). Mr. Lodge is Deputy to the Secretary-General and Legal Counsel to the International Seabed Authority.

⁸⁸ October 14, 2014, Rob Antle, “Ottawa, N.L. Unsure who will pay UN Tax on New Oil Finds,” at <http://www.cbc.ca/news/canada/newfoundlandand-labrador/ottawa-n-l-unsure-who-will-pay-un-tax-on-new-oil-finds-1.2251838>

⁸⁹ *Ibid.*

⁹⁰ *Ibid.*

Although the Article 82 obligation is one of Canada, generically, there is no restriction on Canada implementing this obligation domestically and creating “downstream fiscal burdens.”⁹¹ The resolution of how this obligation is to be funded is a political issue. As noted earlier, amendment to the *Accord Act* may be required. In the case of Canada, this discussion must have regard to its history and the public policy implications of choosing any particular course. Previous sections of this paper have sought to put the current situation in perspective so that at least the following questions may be asked with the benefit of an understanding of this history:

1. Canada has always claimed sovereign rights over the entire continental shelf and has issued exploration licenses based on this since the 1960s. Some of these licenses are in areas beyond 200 NM. If UNCLOS had not been ratified by Canada and production had taken place on the continental shelf beyond 200 NM, the royalties payable by the operators at these locations would have been for the benefit of Canada (or NL following the Accord). Canada either effectively gave up a portion of its royalty income as a consequence of ratifying UNCLOS or created a new international payment burden. UNCLOS, however, as a package deal, provided a great deal of resource advantage to Canada and its citizens. Should producers in areas beyond 200 NM bear all or a portion of the Article 82 obligation?
2. Canada walked away from entitlement to offshore royalties by entering into the Accord. The articulated rationale for this in the Memorandum was so that NL would be recognized as the principal beneficiary of offshore resources as if they were located on land. The statutory scheme sends all royalties to NL. Should NL incur all or a part of the Article 82 obligation and thus jeopardize the equal treatment principle on which the Accord was based?
3. Canada has been tardy in addressing the obligations of Article 82 and in advising companies seeking exploration licenses of their possible obligations. Would it be legally enforceable for Canada to impose a new and substantial financial obligation on a resource operator that it be responsible in some way to pay for these obligations, having not been given any notice to that effect when the operator entered into its original financial commitments to operate on the CS beyond 200 NM?
4. The umbrella of Canadian services provided to participants in the offshore oil & gas business decreases when the activity takes place beyond 200 NM. This is particularly so in respect of fishery activities in international waters. Would it be reasonable for operators on the CS beyond 200 NM to expect the full umbrella of coastal state services?
5. Although the CNLOPB makes no direct suggestion in its 2013 and following calls for bids as to who might be responsible for payment of the Article 82 monies, it does do so in the small text at the bottom of its maps of licensed areas. In this text it is stated that:⁹²

“All interest holders with production licenses containing areas beyond 200 NM may be required, through legislation, regulation, license terms and conditions or otherwise to make payments or contributions in order for Canada to satisfy obligations of Article 82 of the United Nations Convention on the Law of the Sea.”

If this is the position of Canada with respect to the obligation to pay Article 82 monies, can it be said to be appropriate, given the way in which Canada has treated the obligations arising from Article 82 and the history of the development of Article 82? Is this sufficient notice to expect operators beyond 200 NM to conduct their financial modelling on the basis that they will make Article 82 payments?

⁹¹ Chircop, *Supra* Note 57 at 295.

⁹² See map at p. 22.

6. Should Canada accept Article 82 payments simply as a treaty obligation? This argument has been put by Tuerk:

“It seems clear that the obligation to make such payments or contributions is one of the Coastal State and not of the producer. In this context, producers might well argue that they already provide benefits to the economy in the form of taxes, employment and existing royalties so that it should not be incumbent upon them to bear the additional cost of meeting the State’s treaty obligation.”⁹³

It seems obvious that the implementation of Article 82 in the face of a well-developed offshore royalty regime will not be an easy task. One way through this muddle may be for Canada to focus on the purpose of Article 82, which, as stated earlier, is to “address inequity in a practical way.”⁹⁴

Internationally, Canada has addressed inequity through the Official Development Assistance Fund. It has been suggested by Professor Chircop that payments to the Official Development Assistance Fund may be one way in which to implement Article 82 in Canada.⁹⁵ This option has the simplicity of not involving Canada and the provinces in renegotiating the existing royalty structures. This may be a difficult solution for Canada to adopt, given that the amount involved would far exceed the annual current contribution of Canada to the Official Development Assistance Fund. The statute regulating this fund describes the purpose of the fund as follows:⁹⁶

2. (1) The purpose of this Act is to ensure that all Canadian official development assistance abroad is provided with a central focus on poverty reduction and in a manner that is consistent with Canadian values, Canadian foreign policy, the principals of the Paris Declaration on Aid Effectiveness of March 2, 2005, sustainable development and democracy promotion and that promotes international human rights standards.

This section is quite consistent with the expressed purpose of Article 82.

Another option available to Canada is to enter into negotiations with the province of Newfoundland and Labrador to amend the currently royalty arrangements. This option does, of course, run afoul of the basic idea of the Accord, inasmuch as the Accord is founded on the basis that the oil produced from the offshore should be treated in the same manner as if it had been produced from the ground in Newfoundland and Labrador.⁹⁷

The resolution of these questions and others is important to ensure that exploration and production will continue on the Canadian CS beyond 200 NM. Canada must find a way to fulfil its international obligations without putting at risk the continued exploration and development on the Canadian CS beyond 200 NM.

⁹³ Tuerk, *Supra*, Note 51 at 39. Helmut Tuerk is a judge of the International Tribunal for the Law of the Sea.

⁹⁴ Lodge, at fn 88.

⁹⁵ Chircop, fn 55 at p. 301.

⁹⁶ Official Development Assistance Accountability Act (S.C. 2008), c. 17.

⁹⁷ s. 2(e) of the Accord Memorandum at p. 18.

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