

OIL AND GAS ECONOMIC DEVELOPMENT POTENTIAL

PRESENTATION TO THE SENATE COMMITTEE ON ABORIGINAL PEOPLES

October 2005

In southern Canada are located over 60 First Nations that have oil and gas exploration and/or production on their lands. In the last five years Canada has collected over \$1,000,000,000.00 on behalf of these First Nations from oil and gas activitiesⁱ. Almost 200 oil and gas companies have interests on these lands, producing approximately 437,000 cubic metres of oil and 2,193 million cubic metres of natural gas in 2004ⁱⁱ. Some 1.29 million hectares of land are under the control and management of the Government of Canada for the "use and benefit" of First Nations (for ease of reference, "Indian reserves"). Given this statistical base, what are the economic development opportunities for these First Nations?

I The Indian Oil and Gas regime south of 60

At law First Nations presently do not have the right to develop and exploit the oil gas resources underlying their reserve lands if this requires alienation or disposition of any portion of these lands to third parties.ⁱⁱⁱ As a result, First Nations must rely upon the Crown's trust and fiduciary obligations to them to administer these resources and to collect their royalties. These trust and fiduciary obligations have arisen from a number of sources, including the inherent rights of First Nations, treaty rights, the Constitution of Canada and, most importantly, the actual terms of the mineral "surrenders" to the Crown that are required before oil and gas leasing can take place.

The Government of Canada has further defined its role in the administration of First Nations' oil and gas resources in the *Indian Act*, the *Indian Oil and Gas Act* and the *Indian Oil and Gas Regulations*. The overall effect of this legislation is that a First Nation may not directly dispose of its lands, any rights attached to its lands or any minerals located on its lands, to a third party.

Any disposition or grant of a First Nation's mineral interests to a third party, such as an oil and gas lease, requires that the particular right or interest in land that is being sought by the third party, must first be "surrendered"¹² to the Crown. Once the interest in the land or the specific minerals has been surrendered to the Crown, the legislation obligates the Crown to deal with the surrendered lands or mineral interests for the "use and benefit" of the First Nation.

Thus the Minister of Indian Affairs has a fiduciary or trust obligation to manage the exploration and development of First Nations' oil and gas resources in the best interests of the respective First Nations. In southern Canada this duty has in large part been delegated to a separate branch of the Department of Indian Affairs and Northern Development ("DIAND") known as Indian Oil and Gas Canada ("IOGC"). As a Special Operating Agency, IOGC's mission is "to work together to honourably fulfill Crown obligations pertaining to the management of Indian oil and gas resources and to encourage and support First Nation initiatives to control their resources."^{iv}

II Her Majesty as trustee: help or hindrance?

Unfortunately, the Government of Canada, or more particularly DIAND, has been a very reluctant landlord of Indian oil and gas interests. The history and culture of DIAND dictate that the department's mandate is to look after poor and destitute Indians. Oil and gas producing First Nations are not considered poor and destitute by DIAND. Consequently, there is an underlying attitude at DIAND that resents the fact the department must collect and manage oil and gas royalties for First Nations who, in the mindset of the public service, should not need their assistance.

The ensuing reluctance of DIAND to administer and collect Indian royalties manifests itself in a number of ways. Consider for example the fact that oil and gas have been produced from Indian reserves for over 50 years and that most of the larger oil and gas pools on Indian reserves were discovered in the 1950's and 1960's. Throughout the entire period that royalties have been paid there have been a multitude of gray areas in terms of how these royalties should have been calculated. With a reluctant landlord, however, many of these gray areas have never been addressed, let alone clarified. As a result, a number of issues have gone unresolved for many, many years.^v

Another twist to this problem arises from the fact that Indian oil and gas royalties go into the Consolidated Revenue Fund, the same place all federal tax dollars go. Royalties are in fact payable to the Receiver General, the same person who collect our income taxes, Goods and Services Taxes, excise duties, etc. The Receiver General then deposits these payments into the Consolidated Revenue Fund along with taxes and other stipends paid to the Government of Canada. At any given point in time the Government of Canada is notionally holding and owing to First Nations upwards of a billion dollars in Indian royalties paid to the Government of Canada, but not yet distributed to the beneficiary First Nations. Because the federal treasury enjoys the use of these funds, the Minister of Finance does not necessarily share DIAND's reluctance in collecting Indian oil and gas royalties!

In addition to royalty payments, all bonuses and rentals from oil and gas leasing on Indian reserve lands are deposited into the Consolidated Revenue Fund. Rentals and other income are termed "revenue monies", while bonuses and royalties are termed "capital monies". Although this may be changing^{vi}, up until now these "capital monies" have been released to the First Nation if and when the First Nation satisfies the Governor in Council, not just the Minister of Indian Affairs, that they will be expended for the use and benefit of the First Nation. Thus Canada maintains no separate accounts holding bonuses and royalties from Indian reserves.

The Government of Canada agrees that it is holding these monies in "trust" for the respective First Nations. However, the Receiver General has no segregated deposit trust accounts in the name of each First Nation. These monies are instead only notionally owed to the First Nations by the Government of Canada. Indian royalty moneys are handled in a manner similar to, for example, Employment Insurance premiums and Canada Pension Plan payroll deductions. All of these payments to the Receiver General essentially become part of the national debt the day the Receiver General cashes the cheque from the oil and gas producer.

III Hindrance

Historically, not all resource rents from Indian reserves in the form of lease bonuses and royalties have been paid to First Nations. If one harkens back to those grand old days in the 1970's and 1980's when the price of oil went from approximately \$3.00 per barrel in the summer of 1973 to \$35.00 per barrel at the beginning of 1986, one can only hope that in the present situation of once

again rapidly increasing oil and gas prices, history does not repeat itself. In the 1980's the economies of Alberta and Saskatchewan were booming, a result of such phenomena as "windfall profits", "cartels" and "blue eyed sheiks". Although these terms were used pejoratively to assess blame for skyrocketing oil prices, they were never actually defined, nor was the causal connection leading to high prices explained. Nor was it ever recognized that in terms of oil and gas produced from Indian reserves, the blue eyed sheiks were actually working for INAC and the windfall profits went to the federal Department of Finance, not to the First Nations.

Indian oil royalty rates did increase substantially in this time period. However, from 1973 to 1985 Indian oil royalties were calculated and paid on a domestic price that was below the market price for this oil. As a consequence, Canadian consumers and the Government of Canada (and to some extent the provincial governments) received a benefit of almost \$2,000,000,000 that would otherwise have been paid to the First Nations from whose lands this oil was produced. This money was never credited to First Nations' capital and revenue accounts in the Consolidated Revenue Fund. The fact that the Government of Canada had such tight legal control of Indian oil and gas resources enabled this to occur.

While it remains to be seen whether such a wholesale appropriation of the value of Indian lands was in keeping with the Crown's fiduciary obligations to First Nations, it is no coincidence that oil and gas prices have increased substantially once again and the Government of Canada continues to retain control of these resources in order to "act" once more should it feel it necessary.

Issues such as this over resource rent sharing between governments and First Nations resulted in a number of lawsuits and royalty disputes before the courts. It is the hope that this scenario will not be repeated in the 21st century.

IV The Dawning of a New Era

Presently before Parliament is Bill C-54, the proposed First Nations Oil and Gas and Moneys Management Act ("FFNOGMMA"). This legislation is designed to enable First Nations to gain greater control over their oil and gas resources. It is hoped that a First Nation opting into this

legislation will be able to rectify the sins of the Government of Canada that have been set out above. How exactly will a First Nation be able to do this?

Under FNOGMMA, even though title to the oil and gas rights remains with Her Majesty^{vii}, a First Nation will have the power to issue its own oil and gas leases^{viii}. Leases will no longer have to be approved, issued and managed by Indian Oil and Gas Canada. The First Nation will not be bound by the restrictions and reticence that Indian Oil and Gas Canada currently is subject to. As a consequence, more imaginative lease terms should lead to more value-added returns to the First Nation.

For example, although the legislative regime Indian Oil and Gas Canada operates under has always permitted Indian Oil and Gas Canada to take its royalty interest “in-kind”, it very rarely does so. Under FNOGMMA, a First Nation will be able to do so and thus realize added value from the oil and gas products extracted from its reserve.

FNOGMMA also contains broad law-making powers in regard to the “exploration and exploitation” of oil and gas resources located on Indian reserve lands. This law-making power is essentially a codification of First Nations’ inherent law-making powers. Canada could have delegated to First Nations its existing rights and obligations we have set out above, but instead chose not to.

Instead, Canada is being released from its fiduciary and trust obligations arising from mineral surrenders to it^{ix}, in exchange for Canada’s recognition of the First Nation’s inherent beneficial ownership and jurisdiction over the oil and gas resources situated on that First Nation’s reserve lands. FNOGMMA does away with the former mineral surrenders to Her Majesty^x, thus once again vesting the First Nation with the legal title to its mineral rights that it originally owned prior to Treaty. Therefore, a First Nation will not be taking over the existing role of Indian Oil and Gas Canada, but will rather exercise its broad, inherent law-making and proprietary powers.

A First Nation will be able to deal with oil and gas from the discovery stage, then the production stage, and then all the way through to the processing stage. It will be able to maximize the economic rents from the resource through royalties, taxes, and equity and working interest participation in the actual commercial activities. In terms of oil and gas production and the use of petroleum and natural gas products, it will be the maker of its own destiny.

Unlike under the present regime, First Nations will not be restricted to only enjoying those economic benefits accruing simply from the sale of the resource. First Nations will now be able to engage in value-added secondary and tertiary processing activities. Gas processing and hydrocarbon upgrading will be facilitated by FNOGMMA.

ⁱ Indian Oil and Gas Canada website.

ⁱⁱ Indian Oil and Gas Canada website.

ⁱⁱⁱ *Indian Act* and originating as far back as the Royal Proclamation.

^{iv} IOGC annual report.

^v There are a number of outstanding lawsuits in regard to oil and gas royalties that have been initiated by the Saddle Lake First Nation, the Enoch Nation, the Samson Cree Nation, the Ermineskin Nation, the Montana Nation, the Louis Bull Nation and the Stoney Nakoda Nations.

^{vi} Specific Purpose Expenditure Trust ...

^{vii} Section 3 Bill C-54.

^{viii} Section 34 Bill C-54.

^{ix} Section 28 Bill C-54.

^x Section 21 Bill C-54.