CANADA'S ENERGY FRONTIERS

A FRAMEWORK FOR INVESTMENT AND JOBS

Cat. No. M27-73/1985E

ISBN 0-662-14392-2

TABLE OF CONTENTS

A NEW ENERGY POLICY DIRECTION

Over the past year, the Government of Canada has dramatically altered the direction of Canadian energy policy. The energy sector generates a large share of Canada's total investment, trade and income, and represents a vital source of employment for Canadians. It was recognized that energy could be a leading edge of Canada's economic renewal if it were freed from the burden of excessive government intervention, and the uncertainty created by disputes between the federal and provincial governments.

Now, decisions have been made that constitute another major initiative by the Government of Canada to realize the full potential of Canada's energy industry. The fiscal and management framework for oil and gas exploration and development in Canada's frontier regions is being changed. Taken together with the pricing and taxation changes implemented by the Western Accord, the decisions being announced here fulfill the Government's pledge to eliminate the previous government's National Energy Program, which has been so damaging to Canada's energy and economic interests.

The objectives that have guided the Government's energy policy were set out by the Progressive Conservative Party Caucus at Prince Albert in 1984:

- development of Canada's energy resources as an engine for economic growth;
- achievement of energy self-sufficiency;
- increased Canadian participation in the petroleum industry;
- fair treatment for energy consumers and producers; and
- cooperation between the federal and provincial governments, and the industry, to achieve a stable policy environment.

On February 11 of this year, the Government of Canada and the Government of Newfoundland and Labrador signed an historic document ending years of acrimony over offshore energy management and revenue sharing. The Atlantic Accord establishes a joint management regime for the offshore based upon the principle of equality of governments and provides for the sharing of hydrocarbon resource revenues on the same basis as that for producing provinces in western Canada.

Then, on March 28, only a month and a half later, the Western Accord was reached with the producing provinces of British Columbia, Alberta and Saskatchewan. The Western Accord eliminated many of the discriminatory and interventionist policies of the five-year-old National Energy Program and replaced them with a market-responsive pricing system and a profit-sensitive fiscal regime. Oil prices were deregulated and controls on short-term oil exports were lifted as of June 1, 1985; a long list of federal oil and gas taxes was removed or phased out; and the phase-out of the Petroleum Incentives Program, which discriminated against foreign investment, was announced.

These agreements have done a great deal to restore federal-provincial harmony, to place greater reliance on the market, and to restore a sense of fair play for consumers, industry, and different regions of the country. As a result, the way has been opened for renewed growth and investment in Canada's energy resources.

Canada is in an enviable energy supply position. But we cannot afford to be complacent. The frontier regime established in the National Energy Program was very strongly criticized by the oil industry, Canadian business in general, and by our trading partners. It impaired Canada's energy and economic performance. This Government recognizes that the frontiers can make an important contribution to Canada's long-term energy security, and to our economic growth. But to realize both requires new policies now – policies that encourage rather than smother initiative, policies that replace taxpayer subsidies with private equity, and policies that pursue the national interest rather than nationalization.

As comprehensive as the policy changes described in this document are, however, they still describe only one aspect of the Government of Canada's approach to managing frontier energy resources. The other aspect relates to shared management.

Shared management, based upon the principle of equality of governments, is a reality in Newfoundland. Cooperative arrangements are already in place with Nova Scotia and these are to be revised in keeping with the principle of equality. The Government of Canada has a clear commitment to shared management with other coastal provinces, and in the North. The structure and scope of shared management will be matters for bilateral discussions and may vary according to regional circumstances and priorities. The decisions set out here neither anticipate nor prejudice the outcome of these discussions. They do set a broad and consistent policy framework within which equality in shared management can be fully realized.

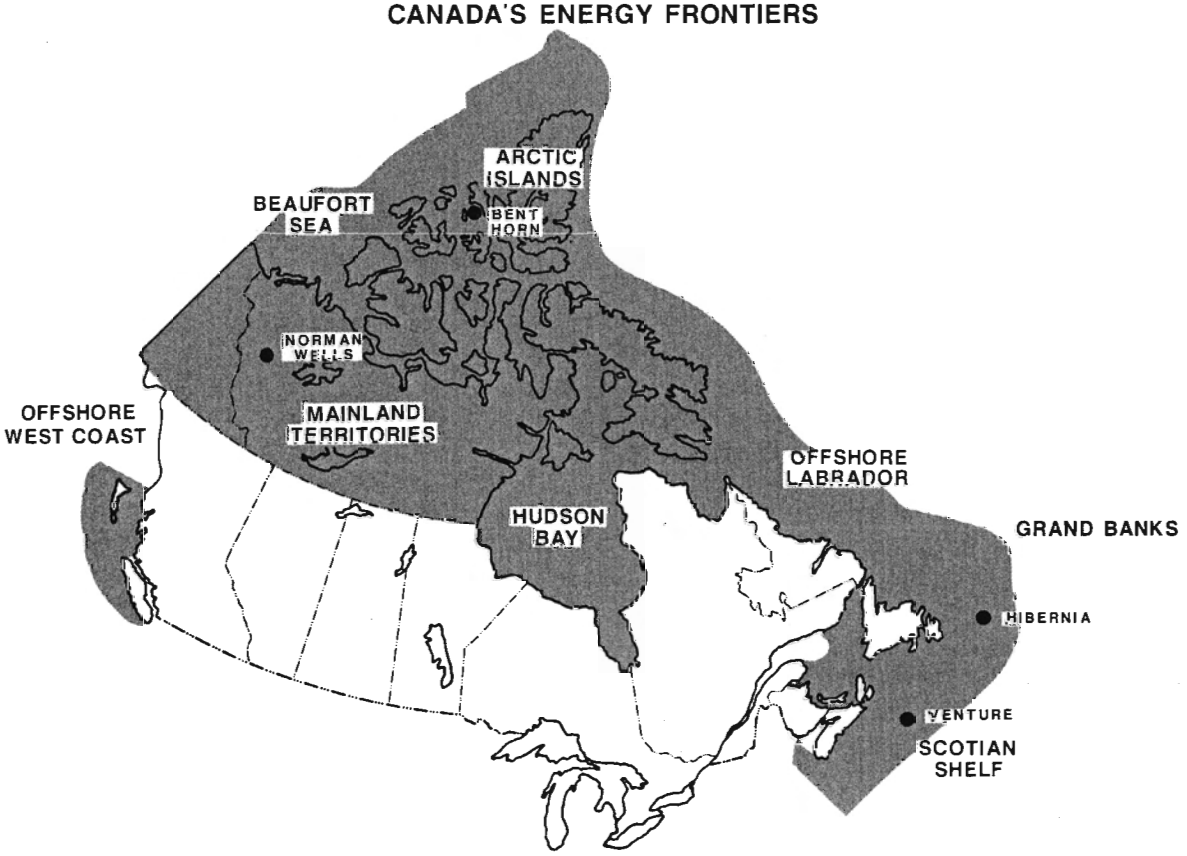
CANADA'S ENERGY FRONTIERS

The Canadian oil and gas industry is a vital element of the Canadian economy. The sector accounts for more than 12 per cent of total investment in Canada, 10 per cent of the value of our exports, and is responsible for hundreds of thousands of jobs, all across Canada. This strength is founded on the exploration for, and development of, Canada's oil and gas resources. To date, most of this activity has been in western Canada, where it will continue at high levels. As indicated below, Canada's vast frontier resource wealth also represents major opportunities for continued growth, investment and job creation.

Canada's energy frontiers comprise the Continental Shelf and 200-mile offshore economic zone, and the Yukon and Northwest Territories – some 10 million square kilometres, or almost twice the area of the 10 provinces combined. With an estimated resource potential of 4.7 billion cubic metres (29.3 billion barrels) of oil and 7.9 trillion cubic metres (279.3 trillion cubic feet) of natural gas, these areas will play an increasing role in Canada's energy supply picture in the years ahead.

Although frontier exploration activity commenced in the Northwest Territories in 1919, offshore exploration did not begin until 1966 when an exploration well was drilled on the Grand Banks, off the coast of Newfoundland. To the end of 1984, there

CANADA'S ENERGY FRONTIERS



have been more than 1200 exploratory wells completed, including some 360 wells in the offshore. Historically, exploration activity has been cyclical, responding to the dramatic increases in world oil prices in the early and late 1970s and major discoveries off the east coast in 1979. There are signs that activity on the frontiers may now have reached a cyclical peak and it is likely to fall back until further major discoveries or rising oil prices give it another lift.

To date, frontier discoveries account for reserves of 410 million cubic metres (2.57 billion barrels) of oil and 960 billion cubic metres (33.8 trillion cubic feet) of gas. Two discoveries, the Venture gas field offshore Nova Scotia and the Hibernia oil field offshore Newfoundland, are proceeding to development. In the North, Norman Wells, which began production in 1932, has recently completed a major expansion. The commencement of production from Bent Horn this summer is demonstrating the technical and economic feasibility of petroleum development in the High Arctic. Oil reserves discovered in the Beaufort Sea are also nearing the threshold required to justify development.

Over all, then, Canada's energy frontiers – those areas beyond provincial boundaries – are vast in area, hold considerable oil and gas potential, and are beginning to produce real energy and economic benefits for Canadians.

THE PRINCIPLE OF SHARED MANAGEMENT

This Government's energy policy is founded on a new relationship between government and industry in which the rules are known, their roles are distinct, and the rights and obligations of each are respected. Similarly, the Government of Canada is committed to redefining the relationship between itself and provincial and territorial governments in a way that recognizes the legitimate voice and aspirations of those Canadians most affected by oil and gas activity in the frontier.

Shared management is at the heart of the Atlantic Accord. It provides for:

- a stable and permanent management regime based upon the equality of both governments in managing the resource, and consistent with the national interest in attaining energy security;
- resource revenue sharing on the same basis as if the resources were on land within the province;
- a stable and fair regime for industry;
- national and regional jobs, and Canadian industry participation on a fair and competitive basis; and
- rigorous protection of the environment and the fishing industry, recognizing these as fundamental regional concerns.

Over the past eight months, the Government of Canada and the Government of Newfoundland and Labrador have worked closely to draft legislation implementing the Atlantic Accord and to establish the Canada-Newfoundland Offshore Petroleum Board. Today, that work is almost complete. The joint Canada-Newfoundland Offshore Petroleum Board is now in place. Legislation to implement the Accord will be introduced shortly to the Parliament of Canada and the Newfoundland House of Assembly.

Discussions are continuing with the Government of Nova Scotia to revise that province's 1982 Agreement in the light of the Government of Canada's new energy principles. The intent of those discussions is to give the provincial government an equal role in offshore management and to provide a firm base for continued exploration, and the development of the Venture natural gas field. British Columbia, Manitoba and Prince Edward Island have also expressed an interest in concluding offshore management agreements in the coming months.

In the North, the Minister of Indian and Northern Affairs has begun discussions on political devolution with the territorial governments. Arrangements for oil and gas resources are an important part of these discussions.

The North is different from other frontier areas in fundamental ways. The prospective oil and gas areas are not just offshore. They are also on land, close to northern communities, and within the traditional hunting and trapping areas of people with unresolved aboriginal claims. An agreement with the Committee For Original Peoples Entitlement has already been concluded and enshrined in legislation. Nothing in this policy statement or proposed legislation will alter the provisions of that agreement and its implementing legislation.

It is the intent of the Government of Canada to discuss with territorial governments how the policy decisions outlined in this statement will apply in the North. Because of the complexity and far-reaching consequences of unresolved aboriginal claims, aboriginal groups must have the opportunity to participate in these discussions to ensure that their rights and interests are protected.

THE NEW LEGISLATIVE FRAMEWORK

The legislative framework for the frontier must be sufficiently flexible to adapt to the varying requirements for joint management and revenue sharing of different regions. At the same time it should, as much as possible, provide consistency in relation to fundamental rights and procedures in all parts of the frontier.

The new legislation will reflect this balance. It has been prepared in consultation with the governments of Newfoundland and Labrador, Nova Scotia, the Yukon and the Northwest Territories. It has also been discussed with northern native groups and with representatives of the industry. The main provisions of the legislation reflect a remarkable degree of agreement by these parties. There are, of course, points on which views differed. However, all parties have accepted that this legislation will serve as the underlying legal framework in the frontier.

Resource management in the frontier is currently exercised on the basis of two federal statutes. The Canada Oil and Gas Act and its regulations govern the economic aspects of management, including the issuance of exploration and production rights and the establishment and collection of royalties and other types of resource revenues. Once rights have been granted, the Oil and Gas Production and Conservation Act of 1969, together with related regulations, governs oil and gas operations in the interests of conservation, environmental protection and safety. These statutes are administered federally by the Minister of Energy, Mines and Resources in the offshore areas south of 60°, and by the Minister of Indian and Northern Affairs in the North. As well, a third statute, the Canada - Nova Scotia Agreement Act, adapts the administration of the underlying legislation to the joint management and revenue-sharing arrangements agreed to in 1982.

The Canada Oil and Gas Act, promulgated in March 1982, has been severely criticized by the oil and gas industry, the financial community and our trading partners. The Government of Canada believes that the far-reaching powers and administrative discretion provided under that Act discouraged investment and job creation.

The Canada Oil and Gas Act will be replaced with a new Act, the Canada Petroleum Resources Act.

Oil and gas management in the Newfoundland offshore will be governed by separate legislation implementing the Atlantic Accord. However, the legislation implementing that Accord will incorporate the new Canada Petroleum Resources Act and the Oil and Gas Production and Conservation Act, while adapting them to reflect the allocation of powers between federal and provincial ministers, and to the joint Canada-Newfoundland Offshore Petroleum Board. Similarly, these acts and their regulations will provide a consistent legislative base for agreements that may be concluded with other coastal provinces, and in the North.

The Canada Petroleum Resources Act differs fundamentally from the legislative framework established by the previous government. While fully protecting the public interest, it is less interventionist and is flexible enough to involve diverse regional interests. It is fair to investors from all countries, and yet supportive of this Government's continuing commitment to Canadian participation. A review of the major policy elements of these legislative changes follows.

RESOURCE MANAGEMENT

The prudent management of Canada's endowment of oil and natural gas is an important economic, social and environmental responsibility of governments. To meet these resource management responsibilities, the rights and obligations of companies wishing to explore for and develop oil and gas resources must be clearly established. This is done through contractual arrangements variously called leases, permits, agreements or licences.

On Canada's frontier lands, three different types of contractual arrangements are used. At the exploration stage, the government may issue exclusive rights to a company to explore for oil and gas on a specific parcel of land for a limited period of time. Under the Canada Petroleum Resources Act, these rights will be called an Exploration Licence. If a company's exploration effort results in the discovery of significant accumulations of oil and/or gas, the company has a right to a Significant Discovery Licence. This licence confers, for an indefinite period of time, the exclusive right to further explore the significant discovery area. If the economics and technology are sufficiently favourable to enable commercial production, a Production Licence will be issued conferring the exclusive right to produce oil and gas from that area for as long as it is capable of commercial production.

Several aspects of the policy and legislation governing the issuing and holding of rights to explore and develop oil and gas resources are in need of change to make them simple, clear and certain.

New Rights Issuance

The terms and conditions under which new rights are issued to the industry have a critical influence on the timing, rate and geographical location of oil and gas activity. They also affect the economic value realized from the resource and its contribution to Canada's energy security.

The existing legislation governing the granting of frontier exploration rights provides for the application of exceptionally broad ministerial discretion. At present, the Minister is empowered to issue rights either through competitive calls for proposals or through noncompetitive direct issuance. Such issuance, including competitive calls, may be based on whatever criteria and as many criteria as are considered appropriate.

In broad terms, governments use one of two competitive systems to issue exclusive exploration rights. An auction system, most commonly used in the United States and in the producing provinces of western Canada, pits company against company to offer the highest bid. The bid is usually in the form of cash, although many alternatives are possible. The process is simple, clear and market-driven.

A concessionary system for issuing rights is used in other petroleum-producing countries, including Norway and the United Kingdom. Unlike the auction system, rights are issued on the basis of a subjective evaluation of multiple criteria. These criteria can include, among others, work commitments, profit-sharing, industrial benefits, the company's track record, and the degree of domestic ownership. Often the selection of a successful proposal will be followed by further negotiations between the company and the government.

Industry has argued against a concessionary approach because it is never sure how a winning bid is selected. While recognizing the need for some government flexibility, it prefers the clarity of an auction system, which sets out one clear criterion and awards land to the highest bidder. The Government finds these arguments compelling. Moreover, it is convinced that a simple, clear and competitive system for exploration rights will ensure the maximum return to Canadians as the resource owners.

The Government of Canada will implement a rights issuance process based on a single, quantifiable bidding subject with rights going to the best bid. Governments will continue to have the authority to reject any and all bids.

The Government believes that it is desirable to maintain considerable flexibility in the selection of an appropriate bidding subject to fit the circumstances of a particular call for proposals. The key determinants of this choice will be geological prospectivity, and the policy objectives of the adjacent coastal province, or northern territory. For highly prospective areas, such as those close to an existing commercial discovery, a cash bonus may be the most appropriate. Where the exploration effort is less mature, and the risk correspondingly higher, a form of bidding on the dollar value of work committed may be more suited to the circumstances.

Consistent with this "best bid wins" approach, there would be no post-bid negotiations with the successful bidder. Accordingly, other rights and obligations under the Exploration Licence will be specified in the call for proposals. Provincial and territorial governments, taking into account regional interests, will have a major role in establishing these pre-bid requirements. These will typically be quite limited but would include the term of the Exploration Licence and any rights relinquishment during the term and could also include aboriginal or community participation, Canada and local benefits and Canadian participation.

Direct Issuance

Rights issuance on a direct, noncompetitive basis is one of the most controversial powers established under the Canada Oil and Gas Act. The possibilities for abuse or the appearance of abuse are evident.

The Canada Petroleum Resources Act will limit the power to direct issue rights to two exceptional circumstances. The first is in the case of error, either on the part of the Crown or an interest holder. The second is to permit a negotiated exchange of rights, for example, in the event of an international boundary settlement or environmental moratorium.

Term of New Rights

The length of term of an Exploration Licence is a critical element of any rights issuance policy. Industry's major concern is that the term be sufficient to permit a company to properly evaluate resource potential. The goal of the federal government is to promote efficient and timely exploration by the licence holder and to ensure that rights are recycled at a reasonable rate.

The Government of Canada has decided that a fixed term, not to exceed nine years, will be included in all Exploration Licences. At the end of the fixed term set in the Exploration Licence, interest holders will be required to surrender all the rights under the licence except any hydrocarbon discovery areas.

The Rate of Rights Issuance

A necessary concomitant to a full relinquishment policy is a balanced rights issuance policy. While there has been relatively little prospective Crown land available, rights issuance in the frontier regions has been at a virtual standstill for 15 years. This is not the kind of record that instills confidence in industry or that will move Canada closer to energy security. A different approach will be required as more prospective land is relinquished into Crown reserve.

The Government of Canada proposes to enter into discussions with the coastal provinces and northern territories with the intent to put in place a rights disposition plan. Rights made available during the period of the plan would, as far as possible, be based on industry nominations. Subject to regional objectives, each regional rights issuance would be scheduled to ensure a balanced rate of issuance between regions and a steady overall rate of issuance on Canada's frontier.

Renewals of Existing Rights

The Government of Canada is committed to providing the holders of existing exploration agreements with an opportunity for a second term provided the requirements of the initial term have been fulfilled. The provincial and territorial governments agree. The terms and conditions of some one hundred agreements are expected to be established over the next two years as the exisiting agreements expire.

There must be reasonable terms and conditions for all second-generation agreements. Terms will be shortened to a maximum of four years since these exploration agreements will deal with smaller areas that will have already been explored. However, there will be a provision in legislation to permit the extension of existing rights in regions where it is not possible to balance relinquishment with new rights issuance. At the end of the term, the interest holder will be required to

surrender all the rights except those associated with hydrocarbon discovery areas. This will ensure that companies actively pursue effective and efficient exploration programs. Carrying charges in the form of minimum work commitments or rentals may also be set in some circumstances.

Extraordinary Powers

The Canada Oil and Gas Act vests the Government with a number of extraordinary powers concerning oil and gas exploration and production in the frontier. Sections 45(1) and 47(1) of the Canada Oil and Gas Act empower the Minister to order the drilling of up to three wells, simultaneously, on a significant discovery area, and an unlimited number of wells on a commercial discovery area. The purpose of this provision is to ensure that discoveries are developed at a pace consistent with Canada's energy and economic interests. However, the Government considers the extent of these powers excessive.

Drilling orders for significant discoveries will be retained in the Canada Petroleum Resources Act but this authority will be circumscribed by reducing the maximum number of wells that can be ordered at any one time to one. Futhermore no orders can be issued to an interest holder during the first four years of the exploration licence under which the discovery was made or if the interest holder has drilled a well within the previous six months.

For commercial discoveries, the Canada Petroleum Resources Act will provide for a "fixed term order" and "show cause process". Under the show cause process, an interest holder will be required to demonstrate the technical or economic problems which prevent the development of the discovery. If insufficient cause is demonstrated, the interest holder may be issued with a fixed term order limiting the term of the interest to three or more years unless production commences during that term.

Section 48 of the Canada Oil and Gas Act empowers the Minister to order, without compensation, the alteration of the rate of production or to deliver production to a particular market at a specific rate and price. Such a power goes well beyond the level of flexibility needed to protect government interests and is unnecessary given other federal energy legislation and emergency powers. Its presence also jeopardizes investment.

There will be no production and disposition orders in the Canada Petroleum Resources Act.

These decisions establish a less complex and more stable management regime. The rights issuance process will be objective and straightforward; the terms and

conditions of rights will be fair; and the government's authority to modify rights will be limited to situations where commercial objectives significantly depart from Government objectives. Together, these policy and legislative actions will provide a much improved investment climate for the industry, while ensuring that governments fully meet their economic, social and environmental resource management responsibilities.

FISCAL REGIME: A CHANGING ENVIRONMENT

The Government believes that a high level of petroleum investment and job creation in Canada can best be achieved by enhancing the rewards from success rather than subsidizing effort. The decisions in the Western Accord to remove or phase out several taxes on the oil and gas industry will make the oil and gas tax regime more profit-sensitive. At the same time, the federal government announced the phase-out of the costly Petroleum Incentives Program, which was criticized by the industry itself as promoting drilling for dollars rather than drilling for oil. The effect of these changes is to shift to industry a greater portion of the risks and the rewards of oil and gas exploration and development -- a principle that was broadly endorsed by the industry during consultations leading to the Western Accord.

Royalties

The Atlantic Accord transferred the responsibility for establishing royalties and provincial-type taxes to the Government of Newfoundland and Labrador. In time, similar treatment may be accorded to other jurisdictions. In the interim, however, it is essential to send an early signal to industry regarding the Government's view of an appropriate royalty regime. Indeed, the Western Accord noted that the frontier royalty regime would be reviewed in consultation with provincial and territorial governments. From this review, it is clear that the current royalty regime is not sufficiently sensitive to the high costs and long lead times involved in frontier development. As a consequence, potentially viable projects could be rendered financially unattractive. Changes to such a regime are a costless fiscal initiative. Practically no revenues are being collected under the current regime, and without major changes to promote development, royalty revenues would never be significant.

Therefore, for regions of the frontier where the responsibility for establishing royalties has not been transferred from the federal government, the following changes will be made to the frontier royalty regime:

The 10-per-cent Basic Royalty and Progressive Incremental Royalty in existing legislation will be eliminated.

These will be replaced with a royalty that, prior to project "payout", commences at a rate of 1 per cent, rising to 5 per cent in increments of 1 per cent every 18 months. Following "payout" of the initial investment, the royalty will rise to 30 per cent of net cash flow. The precise definition of "payout", including a fair return on investment, will be the subject of consultations with the industry, and provincial and territorial governments.

In addition, a 25-per-cent investment royalty credit, applicable to frontier exploration well costs equal to or below $5 million, will be available for new exploration wells. The credit will be applied against royalties otherwise payable within the region. The royalty regime will be set out in regulations pursuant to the Canada Petroleum Resources Act.

These changes create a frontier royalty system that is similar to the royalties levied by Alberta on high-cost oil sands and enhanced oil recovery projects in that province. Within these parameters, negotiations may be required to reflect the special circumstances of major development projects on a case-by-case basis. The investment royalty credit will be of particular benefit to lower-cost wells such as those in the Mackenzie Valley. The effect of the new frontier royalty regime will be to limit the royalty burden during early production and on marginal projects. However, when the investment has been recovered, the system ensures an equitable government share of resource revenues.

Exploration Tax Credit

The Western Accord announced that the Petroleum Incentives Program (PIP) would end by March 31, 1986, and that outstanding investment commitments made under the program would be honoured through "grandfathering" provisions until the end of 1987. Industry has argued strongly that additional exploration incentives are needed to maintain frontier exploration activity. Provincial and territorial governments with a stake in frontier exploration and development have been very supportive of these industry arguments.

Continued frontier exploration and development can make an important contribution to Canada's energy security. The royalty and management provisions of this Policy Statement will provide a very attractive investment climate for the industry. As well, the Western Accord will substantially improve the financial strength of the Canadian petroleum industry over the coming years, thereby enhancing its capability to undertake the energy investments Canada needs.

However, the Government of Canada recognizes that frontier exploration is a high-risk investment, particularly in the light of world energy market uncertainty. Without additional incentives, frontier exploration investment is at a disadvantage relative to other high-risk energy supply projects. As well, an incentive is required to help bridge the gap between PIP availability and frontier oil and gas developments, which will create a new momentum for investment. Therefore, the Minister of Finance will establish a nondiscriminatory, tax-based incentive – the Exploration Tax Credit.

A 25-per-cent Exploration Tax Credit (ETC) will be applicable, across Canada, to exploration expenses above $5 million per well.

To ensure that it assists companies that are currently non-taxpaying, this provision will be refundable at a 40-per-cent rate.

The provision will commence on December 1, 1985, and terminate on December 31, 1990.

The incentive will only be applicable to exploration expenditures that are not eligible for Petroleum Incentive Payments.

These measures will put high-cost exploration investments on a more equal footing with energy investment opportunities in western Canada, including enhanced oil recovery, heavy oil upgrading and oil sands projects. The investment royalty credit described earlier will provide conventional onshore frontier exploration with incentives comparable to those available for similar activity in the western provinces.

CANADIANIZATION

The Government believes in the importance of developing a strong presence for Canadian-owned companies in all aspects of the oil and gas business. Given the opportunities, Canadians have the financial and technological capabilities to earn a larger stake in their energy future. The role of government should be to provide an environment that encourages such opportunities. This has been the Government's approach, and it has worked. Over the past year, Canadian ownership of oil and gas production has increased from about 42 per cent to 47 per cent. This government has achieved more for Canadianization in one year than in the previous three years. This is most welcome and brings our goal of a minimum 50-per-cent Canadian ownership of the industry well within reach. The Government is proud of this record and determined to make further progress.

Canadian Ownership Requirements

Production from the frontier will contribute an increasing portion of Canada's oil and gas supply. A continuing high level of Canadian participation in such projects is central to the achievement of our objectives, and has long been a policy of this Government.

The proposed Canada Petroleum Resources Act will require a 50-per-cent Canadian ownership level at the production stage.

Certain features of the 1982 legislation in this area, however, are unnecessarily onerous and unfair to industry. First, it is retroactive, extending to discoveries made before the 50-per-cent Canadian ownership requirement was legislated in 1982. Second, if a project has a Canadian Ownership Rate (COR) of less than 50 per cent, the existing legislation permits the federal government to expropriate, without compensation, an interest in the project sufficient to raise the COR to the required level. Thus, changes are required:

The Canadian ownership requirement will apply only to production licences relating to discoveries drilled after the promulgation of the Canadian ownership provision of the Canada Oil and Gas Act in March 1982.

Where it is anticipated that the Canadian ownership rate will not meet the 50-per-cent level, the Canada Petroleum Resources Act will require a company applying for development plan approval to submit a plan, acceptable to the Minister, providing for the attainment, by reasonable commercial measures, of a Canadian ownership level of not less than 50 per cent by the time of the issuance of the production licence.

In the event that, despite an agreed Canadian ownership plan, a 50-per-cent Canadian ownership level is not reached by the time of production licence approval, the Minister may require

the auction of that portion of the production licence sufficient to raise the Canadian ownership level to 50 per cent. Such an auction will be subject to a reserve bid established through independent, third-party evaluation of the fair market value.

Canadian companies and provincial and territorial governments will be eligible to bid for such an asset, and the federal government will have the purchase right of last resort, but never at a price that is less than the independently assessed fair market value.

The Government has already taken steps to ensure that the most advanced offshore developments — the Hibernia and Venture projects — will be 50-per-cent Canadian owned. These projects are close to meeting the Canadian ownership objective now: Venture's Canadian ownership is 42 per cent and the recent purchase of Gulf Canada by Olympia and York has raised Canadian ownership in Hibernia from 32 per cent to 47 per cent. In discussions with Mobil concerning that company's acquisition of Canadian Superior, the Government has requested that Mobil sell a sufficient portion of its interest in these projects to raise Canadian ownership to 50 per cent. It will ensure that these projects meet the 50-per-cent Canadian ownership objective in conjunction with the establishment of a fiscal regime and development plan for each project.

The Crown Share

The Government believes that we can meet our objectives for a large, thriving, Canadian-owned component of the oil and gas industry without recourse to unfair measures, or undue government intervention in the private sector. The Canada Oil and Gas Act provides for a 25-per-cent Crown Share in all interests held in the frontier. This measure retroactively changed the rules under which investors had committed themselves to investments on Canada's energy frontier. Perhaps more than any other energy policy measure, the Crown Share has served to erode investor confidence in Canada and create friction with our trading partners. The Prime Minister has undertaken to eliminate this controversial measure.

There will be no Crown Share in the proposed Canada Petroleum Resources Act.

The Role of Petro-Canada

Under the existing legislation, Petro-Canada has special rights in relation to interests acquired as a "designated" Crown corporation in the exercising of the Crown Share and through the back-in provisions of the former 1978 land regulations. For example, Petro-Canada can participate in operating decisions prior to the conversion of the Crown's carried interest to a working interest. As well, for interests acquired from the exercising of the Crown Share or from the back-in, Petro-Canada, unlike any other oil and gas company, could rely on the government to impose an operating agreement on its partners, should it fail to obtain a private agreement.

These measures have not been used. But they have created uncertainty and put Petro-Canada in a privileged position vis-à-vis the rest of the industry. Petro-Canada's role must change. While it, like any other Canadian oil and gas company, will continue to contribute to Canada's energy policy objectives of energy security and Canadian participation, Petro-Canada must conduct its affairs according to the same rules as a private-sector company.

The Canada Petroleum Resources Act will contain no provisions giving rise to preferential treatment of Petro-Canada.

Transfers of Interests

Section 52 of the Canada Oil and Gas Act requires that any transfer of interests be approved by the Minister. This provision increases the credit risk faced by lenders in financing frontier activity because they cannot be assured that they will be able to realize on their security in the event of a default by the borrower. The principal purpose served by this approval process at the exploration stage, to prevent a shifting of Petroleum Incentive Program benefits to noneligible companies, is no longer required, given the phase-out of that program.

In order to maintain a basis for monitoring Canadianization, only a disclosure requirement for transfers of exploration interests will be required by the Canada Petroleum Resources Act.

Because of the Government's concern with Canadian ownership at the production stage, transfers of interests at the production stage will still require government approval.

These changes will encourage far more efficiency and equity in the management of interests.

THE OBJECTIVE – INVESTMENT AND JOBS

The Government of Canada believes that these policy changes set in place an attractive environment for continued exploration and accelerated development in Canada's frontier regions. They establish:

- a stable management regime;
- a profit-sensitive royalty regime;
- nondiscriminatory and regionally balanced exploration incentives; and
- fair Canadianization requirements.

These policy decisions, along with those set out in the Western Accord, provide a firm basis for achieving Canada's energy policy objectives. The enhanced fiscal regime and improved legislative framework have cleared the way for the energy sector to assume its role as the engine of economic growth and for the industry to intensify its efforts to move Canada closer to long-term energy security.

It would be misleading, however, to suggest that government policy alone is sufficient to guarantee investment and jobs. Government does not determine geology and, increasingly, falling world prices are affecting frontier energy investment, both in Canada and abroad. Nevertheless, the Government is convinced that a new frontier energy policy that rewards enterprise and establishes clear rules for participants will provide the framework for the creation of jobs and investment.

The policies set out in this statement enable both industry and Government to work in an environment that recognizes the interdependence between a strong petroleum industry and Canada's energy security and economic development.