THE OIL AND GAS CONSERVATION, STABILIZATION AND DEVELOPMENT ACT, 1973

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The Oil and Gas Conservation, Stabilization and Development Act, which was passed in Saskatchewan in 1973, has far reaching effects on the oil industry in that province, ranging from new forms of taxation to the expropriation of certain oil and gas rights. The Act imposes a mineral income tax on freehold owners and on other persons interested in petroleum production and a royalty surcharge on Crown lands. The group of potential taxpayers has been increased and the author discusses several accounting problems which arise out of the new system. A major concern is the constitutionality of the Act. The author concludes by suggesting methods of drafting future agreements to minimize complications arising from the Act.

I. GENERAL OUTLINE OF THE ACT

The Oil and Gas Conservation, Stabilization and Development Act, 1973[1] was assented to December 19, 1973 and is now amended by Bill 128. Bill 128 has some retroactive effect and the discussion following is based on the Act as the same is amended by Bill 128.

The first portion of the Act imposes what is referred to as a mineral income tax on every person "having an interest in the oil produced from a well". *Prima facie,* this applies to all wells including wells on Crown lands. However, s. 13 indicates that the mineral income tax payable is reduced to the extent of the royalty surcharge imposed pursuant to this Act, the Mineral Resources Act[2] and the Petroleum and Natural Gas Regulations.[3] The royalty surcharge is payable only with respect to Crown lands and thus the mineral income tax is limited to freehold lands. Since both the royalty surcharge and the mineral income tax are calculated in the same manner, a person paying a royalty surcharge with respect to a particular well would not have any liability with respect to mineral income tax. Part I also amends the Road Allowances Crown Oil Act,[4] indicating that the same will be calculated on the greater of the prevailing wellhead price or the wellhead price.

Part II of the Act has the effect of increasing the tax payable pursuant to the Mineral Taxation Act[5] by 250 per cent from 20 cents per acre to 50 cents per acre.

Part III of the Act appears to be an attempt by the Crown to place the distribution of petroleum products on a utility basis. If the Minister establishes a wholesale price, the wholesaler cannot agree to deliver at a price greater than that wholesale price and, in order to determine the wholesale price, s. 24 of the Act gives the Minister power to inspect and audit the books of the wholesaler.

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[1] S.S. 1973-74, c. 72.

[2] R.S.S. 1965, c. 50.

[3] Sask. Reg. 8/69, (1969), 65 Saskatchewan Gazette (Part II) 30, December 28, 1969, as amended.

[4] R.S.S. 1965, c. 53.

[5] R.S.S. 1965, c. 64.

For an integrated oil company, the problems associated with this are large. How does one determine, with any degree of accuracy, the wholesale price for an integrated oil company?

Part IV of the Act has the effect of expropriating the oil and gas rights in all producing tracts, except where the aggregate area of all producing tracts owned by one person does not exceed 1,280 acres. The result is that a good portion of the oil and gas rights in the Province of Saskatchewan are now vested in the Crown and are subject to the royalty surcharge and, hence, are not subject to the mineral income tax.

II. SPECIFIC PROBLEMS WITHIN THE ACT

1. Tax Levied on Whom?

The tax liability in s. 3 appears to be imposed upon "every person having an interest in oil produced from a well". At first glance, it might seem that persons who have no right to take in kind have no "interest" in the oil produced and thus no tax liability. If this were the only section dealing with tax liability, then one would have to become involved in such cases as *Fuller* v. *Howell*,[6] *Saskatchewan Minerals* v. *Keyes*,[7] *Montreal Trust Company* v. *Gulf*,[8] and others to determine whether a royalty owner, an overriding royalty owner, a person owning a net profits interest, *etc.* in fact had an interest in land. If so, it would seem to follow that they had an interest in the substances produced from the land and are liable to tax. Even if one concluded they had no interest in land, the question would still remain whether they had an "interest" in oil produced.

However, s. 4(3) of the Act seems to clarify the issue and indicates that not only those who share in the production must pay the tax but also those who share in the "proceeds of the oil produced from a well".

The tax thus seems to be imposed upon everyone who has an interest in the oil produced or who has an interest in the proceeds of production.

One class of persons has been exempted from the tax liability and that is the fee simple owner who owns no more than 1,280 acres: s. 5.

2. Who Pays the Tax?

Sections 3 and 4(3) indicate that the person liable to pay the tax must pay the same. However, s. 7 of the Act indicates that every "producer" of a well shall deduct and forward to the Minister the tax payable by every person. "Producer" is defined in s. 2(j) in terms that industry would recognize as the "operator", except where unit operations are concerned. In this event, the "producer" is not equated with the unit operator but rather appears to be the person who would have been the operator of the tract before unitization.

The onus placed upon the producer creates problems since the tax payable by another person may be subject to deductions provided for in s. 14 of the Act and these deductions are not known.

3. Quantum of Tax

Without the deductions that may be permitted pursuant to s. 14, the tax is equal to the difference between the wellhead price and the basic wellhead price.

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[6] [1942] 1 D.L.R. 462.
[7] [1972] 2 W.W.R. 108.
[8] [1973] 2 W.W.R. 617.

The basic wellhead price is determined by the Crown and the wellhead price may also be determined by the Crown. Normally, the wellhead price would be the sale price at the wellhead. Hopefully, s. 4A, giving the Minister the right to set the wellhead price, will be used only in those instances in which an integrated oil company is using its own oil and hence cannot buy from itself at the wellhead. However, if the Federal Government imposes another round of price freezes and the world price escalates, perhaps the Minister will again think in terms of the international price, a term used in the legislation until recently amended.

As indicated previously, the tax is the difference between the selling price and the basic wellhead price. However, s. 44 of the Act makes changes retroactive to January 1, 1974. That is, the tax from January 1, 1974 is to be calculated on the difference between the wellhead price and the basic wellhead price, rather than on the difference between the international price and the basic wellhead price. Since the international price is not necessarily the same as the wellhead price and since the basic wellhead price has been changed, the tax payable in the relevant period is different from the tax that was paid.

If there have been intervening changes in ownership, this retroactive aspect will cause problems.

Section 14 of the Act indicates that the tax payable by a person may be reduced, with the approval of the Minister, if the person spends money in various fields, such as exploration, processing facilities, *etc.* The amount of the deduction is at the discretion of the Minister but there is no direction as to how it is to apply; for example, if a person expends $100,000 in seismic surveys and the Minister approves the $100,000 deduction from the tax otherwise payable, how is that tax prorated over the other producing properties owned by that person?

4. Expropriation

Part IV of the Act is that portion dealing with expropriation of fee simple owners holding more than 1,280 acres. Section 28 indicates that as of January 1, 1974, the "oil and gas rights" are vested in the Crown. The oil and gas rights are defined in s. 27(1) and, in effect, are petroleum and natural gas rights in a producing tract or drainage unit down to and including the producing zone. It would appear that all oil and gas rights existing as of the 1st day of January, 1974, are, by virtue of s. 28, vested in the Crown. The Act seems to be silent regarding lands that become oil and gas rights subsequent to January 1, 1974, and there appears to be no procedure provided for subsequent expropriation. Deep rights and other minerals are not expropriated.

The expropriation by the Crown has had the effect of splitting the mineral title. The Crown now owns the oil and gas rights in all zones down to and including the producing formation but the original owner retains the deep minerals and all minerals thereabove which are not petroleum, natural gas, *etc.*, as defined in s. 27(1).

The split mineral title is subject to one lease. Does the well in the shallow rights now extend the term of the lease vis-a-vis the deep rights, or is the lease of the deep rights now terminated for lack of production? If still within the primary term, must the lessee of the deep rights commence delay rental payments or drill the deep rights?

If the lessor has designated a payee pursuant to provisions common in freehold leases, must the lessee continue making royalty payments to that payee until such time as the Crown and the lessor agree on a new payee?

Most of the remaining sections of this Part deal with the mechanics of registering title in the Crown. Some of these sections are somewhat conflicting. For example, s. 28(4) indicates that the Registrar shall enter all necessary memoranda, *etc.* to register and vest the oil and gas rights in the Crown immediately after this Act becomes effective. Section 31, on the other hand, indicates that the Lieutenant Governor in Council shall, as soon as practicable after the Act comes into force, by order, designate the oil and gas rights the Crown acquired. Perhaps the Registrar of Land Titles and the Lieutenant Governor in Council will not agree on what was acquired by the Crown.

The compensation is based on proven recoverable reserves, as determined by the Minister, and wellhead prices. The owner then has an option of receiving this compensation by way of a royalty trust certificate or a lump sum payment discounted over a period of time determined by the Minister and at a rate equivalent to the Bank of Canada's prime lending rate on December 10, 1973. The Act does not indicate when or how the person entitled to the option makes his election.

5. Ancillary Amendments

(1) Amendments to Other Acts

Part V of the Act deals with amendments to the Oil and Gas Conservation Act[9] and s. 38 of the Act appears to make one of the purposes of the Oil and Gas Conservation Act that of protecting and conserving oil and gas resources for the use in the Province by the people of Saskatchewan. Whether this purpose is *intra vires* the Provincial legislative authority is somewhat questionable. In the original Bill 42, s. 39 amended s. 17 of the Oil and Gas Conservation Act and gave the Minister the authority to regulate the production of oil and gas, having in mind not only the market but also the requirement for the needs of the people of Saskatchewan. Again, I think this power raised constitutional problems as to whether a province can regulate a resource for the benefit of that province in preference to other provinces. It is noteworthy that these portions in Bill 42 were deleted by Bill 128.

(2) Offences

Section 42(b) indicates that a person cannot remove production equipment relating to wells, the oil and gas rights of which were acquired by the Crown, without the consent of the Minister. Do operators have to obtain the Minister's approval every time they move a treater or pumping unit? It would seem so.

If the Federal Government implemented its recent tax proposals by not allowing operators to deduct royalties from taxable income, the negative economics of operating some wells in Saskatchewan may be increased if the operator closed the valve. He is then liable to a fine of $1,000 per day for ceasing production: s. 42(a).

(3) Intention of Legislators

Section 42 is enlightening. It attempts to indicate the intention of the Act, that being to confine the provisions to the competence of the legislature. I trust that this is not an indication that their intent might be otherwise with respect to other legislation.

They have also indicated in s. 42A that the Act is to be read distributively and if any Part is *ultra vires,* the remainder is to be interpreted as severable and

[9] R.S.S. 1965, c. 360.

remain *intra vires*. It may well be that the drafters of the Bill had in mind the words of Viscount Simon in *Re Alberta Bill of Rights Act, Attorney-General of Alberta* v. *Attorney-General of Canada*, as follows:[10]

> The real question is whether what remains is so inextricably bound up with the part declared invalid that what remains cannot independently survive or, as it has sometimes been put, whether on a fair review of the whole matter it can be assumed that the legislature would have enacted what survived without enacting the part that is *ultra vires* at all.

The legislators are specifically telling all concerned that they intended to enact the various portions severally. This intention also appears evident from the manner in which the Act was drafted. The Act is divided into six Parts and, except for Parts II, V and VI, each Part has its own set of definitions. Part II deals with an amendment to the Mineral Taxation Act[11] and even without the express intention of the legislation, it would appear severable and one could easily infer that the legislators would have made this amendment regardless of the other portions of the Act.

The same reasoning should apply to Part III, dealing with the regulation of wholesale prices. This Part has nothing to do with mineral income tax, royalty surcharge or expropriation.

However, Part IV, dealing with expropriation, seems to be inextricably tied up with royalty surcharges. For reasons given *infra*, I suggest that if the mineral income tax portion of this Act is *ultra vires*, so is the portion dealing with the royalty surcharge on Crown acquired freehold leases. If such royalty surcharge is *ultra vires*, would the legislators have enacted the expropriation provisions? They say they would in s. 42 and perhaps this is sufficient for the Courts to determine this portion to be severable, assuming it to be *intra vires*. However, if it is inextricably tied up with the royalty surcharge on former freehold lands, as I suggest it is, and the royalty surcharge is *ultra vires*, then it would seem to follow that regardless of the express intention, this portion would also fall.

III. ROYALTY SURCHARGE

1. Levying Legislation

The royalty surcharge is levied pursuant to two Acts. Section 33(2) of the Oil and Gas Conservation, Stabilization and Development Act, 1973[12] levies the royalty surcharge upon "lessees" of oil and gas rights which were acquired by the Crown. Original lessees from the Crown pay the royalty surcharge pursuant to ss. 10(a) and 10(g) of the Mineral Resources Act,[13] the terms of the lease itself and the regulations made pursuant to the Mineral Resources Act. A typical provision in a Crown lease is as follows:

> Rendering and Paying therefor unto the lessor a royalty at such rate and in such manner and at such time as may from time to time be prescribed by Order of the Lieutenant Governor in Council.

A Crown lessee has contractually agreed to a variable royalty.

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[10] [1947] A.C. 503 at 518.
[11] *Supra*, n. 5.
[12] *Supra*, n. 1.
[13] *Supra*, n. 2.

In both types of Crown leases, the lessee is required to pay a royalty surcharge as calculated pursuant to ss. 63 and 63(B) of the Petroleum and Natural Gas Regulations.[14]

2. Levied Against Whom?

As indicated previously, the royalty surcharge is calculated in the same manner as the mineral income tax but, unfortunately, it is not levied upon the same persons. The mineral income tax is levied upon everyone sharing in the production or the proceeds therefrom. The royalty surcharge is levied only upon the lessee. Thus, persons in an override position, *etc.* would, at first glance, appear to be in a favoured position unless the contractual relationship between the lessee and the overriding royalty owner provided otherwise. However, because the overriding royalty owner has not paid the royalty surcharge, he would have to pay mineral income tax. In this instance, the Crown is collecting twice for the overriding royalty share. The lessee is at a disadvantage, since the override would normally be calculated on the basis of sales price and not on the basis of sales price less royalty surcharge.

3. Exemptions

Another problem arises with respect to royalty surcharge. Section 15(3) of the Act empowers the Lieutenant Governor in Council to grant exemptions from the tax imposed. If he grants exemptions with respect to mineral income tax, it would seem a companion exemption should apply to royalty surcharge. However, no similar provision is contained in the Regulations.

4. In Kind

Section 33(1)(b) of the Act indicates that the Minister may require payment of royalties in kind. The Crown claims the royalty surcharge to be a royalty and s. 63(3) of the Regulations also indicates the royalty surcharge may be requested in kind. Since the royalty surcharge is calculated only in dollars, the problem operators face is that of converting these dollars to barrels. Are they to be converted at the selling price, the basic wellhead price, the wellhead price or the premium wellhead price? Since the Crown is claiming its regular royalty on the highest price, normally the wellhead price,[15] it is only reasonable that the royalty surcharge dollars be converted to barrels at this price. However, there are no guidelines in the Regulations.

IV. RECOVERY OF MINERAL INCOME TAX OR ROYALTY SURCHARGE

At the mid-winter conference of the Petroleum Law Foundation, the constitutional aspect of this Act and others was discussed in some detail. I do not propose to deal with this aspect, other than to suggest that the constitutionality of this Act, or portions thereof, is questionable. The main problem associated therewith is how does one protect his client for monies paid pursuant to the Act?

A general supposition seems to be that monies paid under mistake of law are not recoverable unless made under compulsion and under protest: *Maskell* v. *Horner*.[16] At first glance, it would seem to be a matter of not paying the mineral income tax or royalty surcharge until such time as the Crown introduced sufficient grounds to allow the payee to make the payments under protest and

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[14] *Supra*, n. 3.

[15] Sask. Reg. 47/74, (1974), 70 Saskatchewan Gazette (Part II) 203, February 12, 1974.

[16] [1915] 3 K.B. 106.

under compulsion. For most operators in Saskatchewan this compulsion has already occurred in the form of a letter from the Deputy Minister threatening to cancel leases unless the payments are made forthwith.

At this stage, the lessee is not only faced with compulsion but also is faced with s. 5(7) of The Proceedings Against the Crown Act:[17]

> No proceedings lie against the Crown under this or any other section of this Act in respect of anything heretofore or hereafter done or omitted and purporting to have been done or omitted in the exercise of a power or authority under a statute or a statutory provision purporting to confer or to have conferred on the Crown such power or authority, which statute or statutory provision is or was or may be beyond the legislative jurisdiction of the Legislature; and no action shall be brought against any person for any act or thing heretofore or hereafter done or omitted by him under the supposed authority of such statute or statutory provision, or of any proclamation, order in council or regulation made thereunder, provided such action would not lie against him if the said statute, statutory provision, proclamation, order in council or regulation is or had been or may be within the jurisdiction of the Legislature enacting or the Lieutenant Governor making the same.

The effect of this provision was discussed by several of the judges in the Saskatchewan Court of Appeal decision in *Cairns Construction Ltd.* v. *The Government of Saskatchewan.*[18] Gordon J. A.[19] indicates that a person who made a payment under protest and under compulsion would not be able to recover the money paid even if the Act was declared *ultra vires,* since the above section bars any action. His discussion is *obiter dicta* since, while he found the Act in question to be *intra vires,* he also found that the Act did not apply to the plaintiff in question. Culliton J. A., speaking for a majority of the judges in the Court of Appeal, found the Act to be *intra vires* and to apply to the plaintiff and indicates that it was not necessary to consider the effect of The Proceedings Against the Crown Act.[20] Martin C. J. held that the Act in question was *intra vires* and did apply to the plaintiff and did not discuss the effect of The Proceedings Against the Crown Act. The Supreme Court of Canada[21] upheld the majority decision in the Appellate Division of the Supreme Court of Saskatchewan and did not discuss the effect of The Proceedings Against the Crown Act. Davis J., in the Trial Division,[22] indicated that the legislation in question was *intra vires* but did not apply to the plaintiff. He discusses the application of The Proceedings Against the Crown Act, as follows:[23]

> However, as the amendment [The Proceedings Against the Crown Act, s. 5(7)] has to do only with statutes declared to be *ultra vires* and as I have not found the Education and Hospitalization Tax Act to be *ultra vires,* it has no application here. In any case, it is doubtful if it would apply retrospectively so as to encompass the present action and, I may add, I entertain grave doubts as to the legality of the amendment. It may, itself, well be *ultra vires.* . . .

We are thus left with the *obiter dicta* of two judges with respect to The Proceedings Against the Crown Act, one of whom at the Court of Appeal level indicates that it would successfully prevent recovery of monies paid under a mistake of law when paid under compulsion and under protest, and the other

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[17] R.S.S. 1965, c. 87.
[18] (1959) 16 D.L.R. (2d) 465.
[19] Id. at 487.
[20] Id. at 495.
[21] (1960) 24 D.L.R. (2d) 1.
[22] (1957) 9 D.L.R. (2d) 721.
[23] Id. at 734.

at the Trial Court level indicating that the particular provision in The Proceedings Against the Crown Act may well be *ultra vires* itself.

Presently, litigation is under way between Canadian Industrial Gas and Oil Ltd. and The Government of Saskatchewan *et al.*, in which Canadian Industrial is seeking, *inter alia*, a declaration that The Oil and Gas Conservation, Stabilization and Development Act, 1973 is *ultra vires*. This action has not proceeded to trial; however, two motions have been entertained with respect to the action.

One motion is by the defendants, the Crown, who have brought an application for an order to strike out the plaintiff's Statement of Claim or, in the alternative, that the plaintiff's action be stayed by reason of the fact that it has not paid the levies pursuant to the legislation in question.

The plaintiff in turn sought an interim declaration of its rights. In effect, the plaintiff sought a declaration that it would be entitled to a return of the monies paid pursuant to the Act in question if the legislation turned out to be *ultra vires*. It indicated that it would be willing to pay forthwith such monies if the Government would undertake to repay the same if the legislation was declared to be *ultra vires*.

The end result of the applications was that none were granted. Johnson J., in his unreported decision with respect thereto, indicated that the plaintiff's right to question the legislation did not depend upon the prior payment of any sums that may be due thereunder. With respect to the plaintiff's application for an interim declaration of its rights, Johnson J. considered the provisions of s. 5(7) of The Proceedings Against the Crown Act and concluded:

> With considerable reluctance I have reached the conclusion that under The Proceedings Against the Crown Act, I have no power to make the interim declaration sought by the plaintiff. In these proceedings, the plaintiff is placed in a most difficult position and an individual litigant would fare no better. If the plaintiff pays the levy under the Act, it may, by reason of The Proceedings Against the Crown Act, be unable to recover those sums if ultimately it is found by the Courts that they were illegally collected. If it does not pay the levies, then it faces the possible cancellation of the Crown leases on which it has expended money and obtained production. As far as I can determine, a provision similar to s. 5(7) of The Proceedings Against the Crown Act, is not found in similar legislation in any common law province of Canada. It is peculiar to Saskatchewan. It appears to permit the Crown in the right of the province of Saskatchewan, to assert its rights under legislation which might be beyond its powers and thereby achieve the same results as if the legislation were to be found valid. In *Sebel Products Ltd.* v. *Commissioners of Customs and Excise*, Vaisey J. stated:[24]
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> > The defendants being an emanation of the Crown, which is the source and fountain of justice, are in my opinion bound to maintain the highest standards of probity and fair dealing, comparable to those which the Courts, which derive their authority from the same source and fountain, impose on the officers under their control.
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> For the Crown to use what Lord Shaw, in *Food Controller* v. *Cork*,[25] called its 'enormous leverage against all competitors or subjects' is not consistent with the concept of justice which has prevailed in our land. . . .

If Johnson J. is correct in his interpretation of s. 5(7) of The Proceedings Against the Crown Act, then it means that the Saskatchewan Crown can do indirectly what it may not be able to do directly; and that is certainly a novel concept in constitutional law. I understand that at the moment both parties are appealing the decision of Johnson J.

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[24] (1949) Ch. 409 at 413.

[25] [1923] A.C. 647 at 668.

It has been suggested that the prohibitive provisions contained in s. 5(7) of The Proceedings Against the Crown Act relate to the exercise of a power granted by provincial legislation; that a taxing statute is not the exercise of a power granted by provincial legislation, but rather a power granted by The B.N.A. Act and that s. 5(7) thus has no application.

This line of reasoning does not appeal to the writer since every power exercised by the Provincial Crown is derived ultimately from The B.N.A. Act and thus s. 5(7) would be rendered meaningless.

V. *IS THE ROYALTY SURCHARGE A ROYALTY OR A TAX?*

If, for example, the mineral income tax provisions in the Act were found to be *ultra vires* as being indirect taxation, there is little consolation for the lessee unless the royalty surcharge is also *ultra vires*. To be *ultra vires* on the same grounds, the royalty surcharge would have to be characterized as a tax. If the royalty surcharge is a royalty, then presumably it is not a tax.

1. What is a Royalty?

Laskin J., in the *Keyes* case, quotes with approval McRuer J.A.'s definition of royalty in *Re Dawson & Bell*:[26]

> The money paid is the consideration for the right to enter upon the land, drill for oil or gas and take away the same when it is recovered, as distinct from the purchase price of oil or gas reduced to possession.

Although expressed somewhat differently, Viscount Kilmuir L. C. said, in *Perpetual Trustee Company* v. *Pacific Coal Company*:[27]

> They [the Privy Council] think that when a lessee takes and carries away coal he may fairly be described as exercising a right, even although it is a right which is incident to his interest in the soil as lessee. They recognize that sum described as a "royalty" in the mining lease has been held by the Supreme Court to be part of the rent reserved by the lessee, but they think that a rent which is payable at a rate per ton of coal wrought and brought to bank is ordinarily referred to as a royalty. . . .

2. Original Crown Leases

As indicated *supra*, the lessee from the Crown has contractually agreed to compensate the Crown for the right to take "in such manner and at such time as may from time to time be prescribed by Order of the Lieutenant Governor in Council". If the Lieutenant Governor in Council requires not only a royalty but also a royalty surcharge, both would seem to be payments made for the right to take and thus would be royalties.

If the mineral income tax is indirect taxation, it is quite probable that the royalty surcharge with respect to Crown leases is not a tax and does not violate any concept of indirect taxation.

3. Crown Acquired Lands

In s. 33(1) of The Oil and Gas Conservation, Stabilization and Development Act, 1973,[28] the Crown indicates that it has taken the oil and gas rights subject

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[26] [1945] O.R. 825 at 838.
[27] [1956] A.C. 165 at 181.
[28] *Supra*, n. 1.

to existing encumbrances, that is, subject to the existing freehold lease. The Crown is now in a position of lessor *vis-a-vis* the lessee of the freehold lease and the lessee must make regular royalty payments under the lease to the Crown. However, by virtue of s. 33(2) of this Act, the Crown has imposed a royalty surcharge on this lessee and the question remains whether this royalty surcharge can be classified as a royalty.

The Crown was not the original grantor and thus it can hardly be argued that the royalty surcharge is money paid for the right to enter upon land and take away the oil. This right was granted previously by the original freehold owner. The royalty surcharge for Crown acquired lands does not fit the analogy to royalty but does fit that of a tax.

In this case, I suggest that if the mineral income tax is classified as indirect taxation, so should the royalty surcharge applicable to Crown acquired lands.

VI. FUTURE AGREEMENTS

In drafting future agreements, certain points should be clarified.

1. It will be necessary to clarify whether the overriding royalty owner is to be responsible for his proportionate share of the royalty surcharge. If so, provision should be made in the agreement requiring the overriding royalty owner to advance to the operator an estimated amount of his royalty surcharge prior to the time when the operator has to pay the same. This would be similar to the operating fund presently used in most agreements.

2. Since the operator is required to pay the mineral income tax on behalf of everyone, he should receive an indemnity from the others for payments he makes in good faith. For example, if a co-tenant thinks his mineral income tax is overpaid, because of certain deductions, he should be required to settle his dispute directly with the Crown.

3. Since the legislation introduces numerous prices for a barrel of oil, the agreement should clarify what price will be used to determine the override or net profits interest.

4. The legislation indicates that certain credits may be obtained for mineral income tax or royalty surcharge reduction and in other instances outright grants may be obtained. The agreement should clearly indicate how the benefit of these rights or privileges is to be shared.

5. Because the legislation has made some retroactive changes regarding the quantum of mineral income tax or royalty surcharge payable, on any sale or purchase of producing properties during the period January 1, 1974 to May 31, 1974, the parties should consider to whom the benefit or liability of or for these retroactive changes should accrue.

VII. CONCLUSION

The present confrontation between the Provincial and Federal authorities on revenue sharing from oil production does not create an aura of confidence in the industry. The attached comparison of First Quarter drilling activity indicates a substantial decrease in activity over the same period last year, and while it may be that the entire decrease is not attributable to the unfavourable investment climate, it does indicate that, not only is industry concerned, it is doing something about it.

The politicians would be well advised to consider the warnings of industry in the light of industrial activity, and if their policy is to be designed to make Canada self-sufficient in energy resources in the near as well as distant future, changes more favourable to industry will have to occur.

APPENDIX "A"

COMPARISON OF DRILLING ACTIVITY

	Exploratory Wells		*Development Wells*		*Total Wells*		
	1st Qtr 1973	*1st Qtr 1974*	*1st Qtr 1973*	*1st Qtr 1974*	*1st Qtr 1973*	*1st Qtr 1974*	*% Diff.*
Alberta	535	517	360	279	895	796	-11
Saskatchewan	53	21	60	10	113	31	-73
B.C.	69	60	33	29	102	89	-13
Canada	713	637	464	332	1177	969	-18