Appendix A

to the Submission by the Province of Nova Scotia to the Expert Panel on Equalization and the Territorial Financing Formula

Recommendations for Equalization Should Not Undermine the Nova Scotia Offshore Accord

1. Overview

The Nova Scotia Offshore Accord[1] is a bilateral agreement that resolved a long-standing constitutional dispute between Nova Scotia and Canada on jurisdiction over offshore petroleum resources. Nova Scotia agreed to set aside its claim to jurisdiction in consideration of a joint management regime and the sharing of offshore revenues.

Canada's agreement, particularly on the sharing of offshore revenues, was rooted in its constitutional obligation under section 36(1) to further economic development in all regions. By setting aside the jurisdictional dispute, the development of Nova Scotia's offshore resources was expected to proceed, and as was articulated in the 1982 agreement, "For Nova Scotians, development of offshore energy resources offers a unique opportunity to build the lasting social and economic structures that can help to shape a prosperous future".[2]

The 1982 agreement, and its successor, the 1986 accord, provided that Nova Scotia would be the principal beneficiary of the offshore resource revenues until Nova Scotia achieved the agreed per capita fiscal capacity. However, both Canada and Nova Scotia recognized that the Equalization program threatened to undermine the agreement reached on revenue sharing. Thus the Offshore Accord included equalization offset payments to protect the offshore revenues from claw-back. The inclusion of equalization offset payments in the Offshore Accord ensures that the Equalization program does not undermine the revenue sharing set out in the Offshore Accord and thus delay Nova Scotia's achievement of economic sustainability.

The Nova Scotia Offshore Accord is a bilateral agreement, and bilateral agreements are essential to the relationship between Canada and a province. Among other things, they allow Canada to further economic development in a province. It does not follow that, because such agreements may, directly or indirectly, improve the present or future fiscal capacity of a province, they undermine the Equalization program. Otherwise the economic development principle and other legitimate

1 This refers to the *Canada–Nova Scotia Agreement on Offshore Oil and Gas Resource Management and Revenue Sharing* dated March 2, 1982 (1982 agreement) as succeeded by the *Canada–Nova Scotia Offshore Petroleum Resources Accord* dated August 26, 1986 (1986 accord) as supplemented by the *Arrangement between the Government of Canada and the Government of Nova Scotia on Offshore Revenues* dated February 14, 2005 (2005 agreement)

2 *Canada–Nova Scotia Agreement on Offshore Oil and Gas Resource Management and Revenue Sharing*, March 2, 1982, Schedule II.

areas of bilateral agreement between Canada and a province will be impeded**.** Although the Nova Scotia Offshore Accord is one of these important bilateral agreements addressing economic disparity, it is also fundamentally different from program-driven bilateral agreements, because it is founded on Nova Scotia's agreement to set aside its claim to jurisdiction over the offshore.

Some have expressed concerns to the Expert Panel about the Nova Scotia Offshore Accord, suggesting that, effectively, Nova Scotia is receiving "equalization outside of equalization." This suggestion may be the result of a lack of context regarding the constitutional and historic background for the Offshore Accord and the legal and policy objectives it fulfils.

In any event, these concerns are not a part of the panel's mandate; nor have they been identified by the panel for review[3]. Rather, the Expert Panel is interested in the effect on Nova Scotia and other receiving provinces of a change in the existing inclusion rate of 100 per cent[4] for offshore resource revenues that is set out in the Federal Provincial Fiscal Arrangements Act (FAA). Nova Scotia is not affected in the short term, regardless of the inclusion rate for its offshore resource revenues, because Nova Scotia will receive equalization offset payments *under* the Nova Scotia Offshore Accord equal to 100 per cent of whatever claw-back it experiences under the equalization formula.

In effect, the Nova Scotia Offshore Accord and the equalization offset payments required under the Nova Scotia Offshore Accord are insulated from any changes to the Equalization program, in the short term, including any changes to the inclusion rate for offshore revenues. In order for Nova Scotia to be affected, the Expert Panel would need to go so far as to recommend that Canada, through legislation or otherwise, directly target and breach the equalization offset payment provisions of the Nova Scotia Offshore Accord. Not only would such a recommendation by the panel be outside of its mandate, but it would also place

3 *Key Issues for the Review of Equalization and Territorial Formula Financing*, March 31, 2005, at page 20: "Should a new allocation formula exclude *more* than the current 30 per cent of offshore revenues (the current "generic solution under Equalization), both provinces would experience smaller Equalization claw-backs, and smaller offset payments would be owed. The two provinces would obtain a larger share of the fixed Equalization envelope, the other receiving provinces would get less, and the federal government would owe the smaller offset payments. Conversely, should a new formula exclude *less* than the current 30 per cent of offshore revenues, the two provinces would obtain a lower share of Equalization, other provinces would get more, and the federal government would owe larger offsets."

4 Sections 4(10) and 4(11) of the FAA regarding the election of the generic rate of 70 per cent for the inclusion of Nova Scotia offshore revenues in the equalization formula were repealed by Section 3(6) of the Budget Implementation Bill, 2004 effective March 23, 2004.

Canada in the untenable position of undermining or neutralizing the recently finalized revenue-sharing arrangements set out in the 2005 agreement, an act that would call into question the *bona fides* and honour of the federal Crown.

It is important to emphasize that Nova Scotia's offshore resources revenues are included in the Equalization program and that Nova Scotia fully supports the inclusion of all resource revenues, whether onshore or offshore, in the program. Their exclusion would seriously undermine the spirit and intent of the Equalization program by significantly understating the revenues of certain resource-rich provinces. This, in turn, would significantly reduce equalized revenues and would lead to increased disparity in the levels of public services in the receiving provinces, a result that would be at odds with the constitutional principle of section 36(2).

The following submission by Nova Scotia will provide the historical context for the negotiation of the Offshore Accord during the years from 1982 through to 2005 and will also clarify the important legal and policy objectives achieved by the accord.

2. Resolving the Constitutional Dispute over Offshore Jurisdiction

The *Canada–Nova Scotia Agreement on Offshore Oil and Gas Resource Management and Revenue Sharing* (1982 agreement) was signed on March 2, 1982. Its principal purpose was to settle the long-standing constitutional dispute between Canada and Nova Scotia over jurisdiction of the offshore so that development of the petroleum resources could proceed. For this reason, Nova Scotia agreed to set aside its claim to jurisdiction in consideration of a joint management regime and the sharing of offshore revenues.

The 1982 agreement was expressly stated to survive any decision of the courts on the jurisdiction and ownership question:

> "*… this settlement shall survive any decision of a court with respect to ownership and jurisdiction in the geographic area identified in Schedule I, hereinafter called the 'offshore region'.*"[5]

5 *Canada–Nova Scotia Agreement on Offshore Oil and Gas Resource Management and Revenue Sharing*, Introduction.

The 1982 agreement pre-dated the decision of the Supreme Court of Canada on March 8, 1984, in the *Reference re: Seabed and subsoil of the continental shelf offshore Newfoundland*[6] (*Newfoundland reference*) regarding jurisdiction over Newfoundland and Labrador's continental shelf. So at the time that the 1982 agreement was signed, the jurisdiction over Newfoundland and Labrador's offshore had not been decided.

Following the decision in the *Newfoundland reference*, Nova Scotia has consistently asserted that the *Newfoundland reference* did not resolve the question of jurisdiction with respect to Nova Scotia's continental shelf. The historical facts that support Nova Scotia's claim to jurisdiction are distinct.[7] Thus, the constitutional dispute between Canada and Nova Scotia remains unresolved and will probably never be referred to the courts for decision.

Even if the *Newfoundland reference* could have been said to apply to Nova Scotia, it had no effect on the pre-existing settlement between Nova Scotia and Canada because of the survival clause in the 1982 agreement.

The name of the agreement itself, *Canada–Nova Scotia Agreement on Offshore Oil and Gas Resource Management and Revenue Sharing* (emphasis added), also confirms that there were the two main points of settlement: joint management and revenue sharing. Nova Scotia considered the revenue-sharing provisions of the Offshore Accord to be fundamental to its agreement to set aside its claim to jurisdiction over the offshore. But for the revenue-sharing provisions, Nova Scotia would not have signed the 1982 agreement or its successor, the 1986 accord.

6 [1984] 1 S.C.R. 86

7 Section 7 of the *British North America Act* states that, "The Provinces of Nova Scotia and New Brunswick shall have the same limits as at the passing of this Act." Among other grants and historical documents, Nova Scotia relies upon the Royal Charter of King James I to Sir William Alexander on September 10, 1621, granting "… including all the Seas and Islands to the south within forty leagues [140 miles]" of the coast …" And we do by these our Letters Patent, make, unite, annex, erect, create, and incorporate, the whole and entire Province, and lands of Nova Scotia aforesaid, with all the limits thereof, Seas, etc."

3. Economic Development–A Fundamental Principle of the Nova Scotia Offshore Agreement

At the time of the 1982 agreement, development of the Venture Project had stalled while the federal and provincial governments argued about jurisdiction and regulatory regimes. When placed in this historic context, the prime mover for the Nova Scotia Offshore Accord was the regional economic development principle of the Canadian constitution.

Part III of the Constitution Act, 1982 sets out two separate constitutional principles. Section 36(2) speaks to the "principle of [Canada] making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation." It compares current levels of public services and taxation and rebalances revenues on a current basis to assist in the current funding of reasonably comparable levels of public services. The interpretation of this subsection and the practicalities of its implementation form the mandate of the Expert Panel. The equalization principle is applied on a current basis.

Section 36(1)[8] is the principle that is germane to the history of the Nova Scotia Offshore Accord as "promoting equal opportunities for … Canadians and furthering economic development to reduce disparity in opportunities …" This principle is entirely separate from the equalization principle. This economic development principle is mainly prospective and imposes a constitutional obligation to further economic development to reduce disparity in the regions. This is a long-term goal requiring action and investment today to achieve equal opportunity in the future.

The Constitution Act, 1982 came into effect on April 17, 1982, but the earlier 1982 agreement was a harbinger of its principles. When Nova Scotia and Canada set aside their constitutional dispute on jurisdiction to conclude a settlement that resulted in joint management and revenue sharing, what was uppermost in the parties' minds was not the equalization principle of section 36(2) but

8 Without altering the legislative authority of Parliament or of the provincial legislatures, or the rights of any of them with respect to the exercise of their legislative authority, Parliament and the legislatures, together with the Government of Canada and the provincial governments, are committed to
(a) promoting equal opportunities for the well-being of Canadians
(b) furthering the economic development to reduce disparity in opportunities; and
(c) providing essential public services of reasonable quality to all Canadians.

rather the opportunity principle of section 36(1), particularly section 36(1)(a) of "furthering economic development." Schedule II to the 1982 agreement sets out this background in a section entitled Opportunities:

> *"The Canada–Nova Scotia Agreement on Offshore Oil and Gas Resource Management and Revenue Sharing establishes a strong, cooperative management regime capable of vigorously pursuing and harmonizing these energy and development objectives in a manner consistent with the interests and responsibilities of each government, and of industry, as well as of Nova Scotians and all Canadians.*
>
> *In Nova Scotia many onshore opportunities will be provided as a result of offshore oil and gas resource activity. These opportunities will include new jobs and training skills, new business opportunities for industry and entrepreneurs, and significant new government revenues."*

And further on in Schedule II:

> *"For Nova Scotians, development of offshore energy resources offers a unique opportunity to build the lasting social and economic structures that can help to shape a prosperous future."*

At the time of the 1982 agreement, the development of Nova Scotia's oil and gas sector was anticipated to result in the largest economic boom in the history of the province. The development of the Venture Project was imminent, and at the time, it was estimated that the project would generate $3.5 billion in provincial revenues.

The offshore revenues from this and other offshore projects were expected to ensure Nova Scotia's long-term economic sustainability and to reduce its dependence on federal transfers. In the words of Prime Minister Jean Chrétien in 1984, while serving as the Minister of Energy, Mines, and Resources,

> *"… and in the Nova Scotia Agreement, there is a provision that guarantees the province will receive payments to offset the reduction in their equalization payments. These payments will decline over time but provide protection in the early years … to ensure that the province had a real net increase in revenues from the offshore in the early years when it was still a 'have not' province."*

4. Sharing Offshore Revenues

The principle of section 36 (1)(b) of the constitution, furthering economic development to reduce disparity in opportunities, was the reason that Canada and Nova Scotia set aside their dispute on jurisdiction and agreed on joint management and revenue sharing in the expectation that the stalled Venture Project would proceed. This was expected by Canada and Nova Scotia to bring a period of prosperity and to sustain economic development for Nova Scotia as its offshore resources were developed.

Under the 1982 agreement, Nova Scotia was to receive all revenues from the offshore, whether federal or provincial in nature. This was during the time of the National Energy Program (NEP), and the federal resource revenues[9] were very considerable. They included not only the basic royalties, sales taxes, income taxes, bonuses, and licence fees, but also the progressive incremental royalties (PIR) and the federal petroleum and natural gas revenue tax (PGRT). The 1982 agreement provided that Nova Scotia would receive all of these federally created revenues until its fiscal and economic capacity reached a certain level.

Specifically,[10] Nova Scotia would receive 100 per cent of federal and provincial offshore revenues, including PGRT, until it reached 110 per cent of the national average. Then Nova Scotia would receive 80 per cent of federal and provincial offshore revenues, including PGRT, until it reached 120 per cent of the national average. Then it would receive 50 per cent of federal and provincial offshore revenues, including PGRT, until it reached 130 per cent of the national average. Once it attained 130 per cent, it would receive 100 per cent of provincial offshore revenues (provincial corporate income taxes and sales taxes) until it reached 140 per cent of the national average.

Under the provisions of the Federal Provincial Fiscal Arrangements Act (FAA) in effect at the time, resource revenues were included as to 50 per cent only in the equalization formula. Thus the claw-back in equalization payments resulting from the inclusion of offshore revenues would have been 50 per cent. This 50 per cent inclusion rate would have allowed Nova Scotia to make forward progress on its goal of reducing its regional economic disparity and achieving 140 per cent of the national average fiscal capacity.

9 Canada and Nova Scotia each proceeded, despite their negotiations, with offshore resource legislative packages consistent with their respective claims to jurisdiction over the offshore.

10 Article 15.

5. The Need for Equalization Offset Payments

The signing of the 1982 agreement coincided with looming changes by Canada to the FAA. The parties could not disregard the realities of the Equalization program.

They recognized that the amendments proposed by Canada to the FAA to include 100 per cent of offshore revenues in the equalization formula would cause the offshore revenues that Canada had agreed to share with Nova Scotia to be fully clawed back through a 100 per cent decrease in equalization payments. As a result, Canada and Nova Scotia entered into a side letter[11] that required Canada to make offset payments to Nova Scotia to ensure that the agreed-upon revenue sharing would not be undermined by the imminent changes to the FAA:

> "*Revenues received by the province from offshore oil and gas production will cause payments under the equalization program to decline. However, in discussions about the equalization formula, both the federal government and the province have made proposals designed to prevent a sudden and significant loss in equalization. We have agreed that in the event that operation of the equalization program results in payments to the Nova Scotia government which are less than those which it would have received had the federal government accepted the Nova Scotia proposal (attached), the federal government undertakes to remit the difference to the Nova Scotia government.*"

The Nova Scotia proposal was based on a 10-year phase-in of the inclusion of 100 per cent resource revenues in the equalization formula timed to coincide with commercial production from the large-scale Venture Project. All of Venture's substantial revenues, including PGRT, would have gone to Nova Scotia until it attained 110 per cent of national average and, thereafter, a declining percentage of offshore revenues until it attained 140 per cent of national average.

As anticipated, on April 1, 1982, Canada amended the FAA to move to the five-province standard and to include 100 per cent of resource revenues. Therefore, the 10-year phase-in outlined in the side letter superseded Article 15 of the 1982 agreement and was eventually included in the federal Canada–Nova Scotia Oil and Gas Agreement Act that implemented much of the 1982 agreement.

11 Letter dated March 2, 1982 from Minister of Energy, Mines and Resources (Canada) to the Minister of Mines and Energy (Nova Scotia).

6. Dismantling the NEP

A number of significant events occurred between the signing of the 1982 agreement on March 2, 1982, and the signing of the *Canada–Nova Scotia Offshore Petroleum Accord* (1986 accord) on August 26, 1986.

March 2, 1982	*Canada–Nova Scotia Agreement on Offshore Oil and Gas Resource Management and Revenue Sharing* signed
April 1, 1982	Equalization formula amended to include 100 per cent of resource revenues and the five province standard
March 8, 1984	SCC decision on the *Newfoundland reference*
September 4, 1984	Election of Prime Minister Brian Mulroney
February 11, 1985	*Atlantic Accord* with Newfoundland and Labrador signed
October 1985	Repeal of the NEP announced
August 26, 1986	*Canada–Nova Scotia Offshore Petroleum Resources Accord* signed

All of these important events impacted the 1982 agreement. With respect to the sharing of revenues, one of the most important was the dismantling of the NEP. With the dismantling, the large revenues from the PGRT that were to flow to Nova Scotia from the Venture Project disappeared.

7. Reaffirming the Resolution of the Jurisdictional Dispute

In the face of these significant events, on August 26, 1986, Canada and Nova Scotia concluded the 1986 accord[12]. And, unlike the 1985 *Atlantic Accord* that followed the decision in favour of Canada in the *Newfoundland reference*, Nova Scotia again did so without prejudice to its legal claim to jurisdiction of the offshore:

> *"This political settlement of the issues between the Parties has been reached without prejudice to and notwithstanding their respective legal positions. It is the intention of the Parties that this settlement survive any decision of a court with respect to ownership or jurisdiction over the Offshore Area."*[13]

12 *Canada–Nova Scotia Offshore Petroleum Resources Accord.*

13 Recitals, paragraph 3 to the *Canada–Nova Scotia Offshore Petroleum Resources Accord.*

Under the 1986 accord, Canada and Nova Scotia also agreed "… to establish through *mirror legislation* a unified administrative and fiscal regime for Petroleum Resources in the Offshore Area" (Emphasis added)[14]. It is a testament to the importance of resolving this constitutional issue that each of Canada and Nova Scotia proceeded and each passed mirror legislation to implement the management and revenue-sharing principles of the 1986 accord. This mirror legislation approach confirmed that each of Canada and Nova Scotia continued to recognize and to concede that the other claimed constitutional jurisdiction over the offshore.

Canada also agreed to entrench the principles of the 1986 accord, including the provisions on joint management and revenue sharing, in the constitution. Article 42 provides:

> "*Upon the achievement of such support as may be required, the Government of Canada shall introduce a resolution satisfactory to the Province of Nova Scotia to amend the Constitution of Canada to entrench the principles of this Accord. The form of the resolution shall be acceptable to the Parties.*"

The willingness of Canada to undertake an amendment to the constitution confirms that the principles of joint management and revenue sharing were fundamental to the resolution of the constitutional dispute on jurisdiction.

The 1986 accord also required Canada to make Crown share adjustment payments to Nova Scotia.[15] The original Crown share was an ownership interest in all offshore projects reserved by Canada under the NEP. Under the 1982 agreement, Nova Scotia acquired a portion of Canada's Crown share in the offshore projects. The Crown share adjustment payments in the 1986 accord compensate Nova Scotia for the loss of this ownership interest that resulted from Canada's decision to repeal the Crown share as a part of the dismantling of the NEP. The ownership interest acquired by Nova Scotia under the 1982 agreement and the compensating Crown share payments agreed to by Canada in the 1986 accord underscore the nature and genesis of the Nova Scotia Offshore Accord in ownership and jurisdiction.

The importance that each of Canada and Nova Scotia attached to this bilateral agreement is inconsistent with the characterization by some of the 1986 accord as an

14 Recitals, paragraph 2 to the *Canada–Nova Scotia Offshore Petroleum Resources Accord.*
15 Article 45, *Canada–Nova Scotia Offshore Petroleum Resources Accord.*

"ad hoc deal" that was intended to rebalance or undermine equalization principles. It was entirely separate from the FAA and equalization. The Nova Scotia Offshore Accord was about settling jurisdiction of the offshore so that development of its resources could proceed. That development was expected by Canada and Nova Scotia to reduce economic disparity in accordance with section 36(1)(b) of the Constitution Act, 1982.

8. Continuing Equalization Offset Payments

The 1986 accord provided that Nova Scotia would have

> *"Responsibility for, control of and revenues from fiscal instruments … as if … the Petroleum Resources were located on the land portion of the Province of Nova Scotia."*[16]

The lucrative federal PGRT of the NEP was gone. Canada recognized Nova Scotia's right to establish its own fiscal regime with respect to offshore revenues. But a continuing and critical component was the equalization offset payments by Canada to Nova Scotia to ensure that the equalization formula did not effectively undermine the revenue sharing that was an essential part of Nova Scotia's agreement to set aside the constitutional debate on offshore jurisdiction.

The offset payments were graduated over a 10-year period intended to coincide with production revenues from the Venture Project. The formula was the same as agreed by Nova Scotia and Canada in the side letter dated March 2, 1982 and as had been included in the federal legislation, Canada–Nova Scotia Oil and Gas Agreement Act that implemented parts of the 1982 agreement. Beginning during a three-year window following the commencement of commercial production, Canada agreed to make an equalization offset payment to Nova Scotia over 10 years equal to 90 per cent of offshore revenues in the first year and declining by 10 per cent per year.[17]

Unfortunately, the Venture Project was shelved shortly after the 1986 accord. The marginal Cohasset-Panuke Project was the first Nova Scotia project, and its small-scale production triggered the 10-year equalization offset payments from Canada beginning in 1993–94.

16 Article 26.01.
17 *Canada–Nova Scotia Offshore Petroleum Resources Accord Implementation Act*, Sections 223–225.

In March 2004, Canada included as a part of the Budget Implementation Act, 2004 a provision that effectively restarted the 10-year period in 2000–2001 to coincide with the start-up of the Sable Project[18]. The amendment resulted in two additional equalization offset payments to Nova Scotia for 2004–2005 and 2005–2006.

Also in 1994, Canada unilaterally introduced the generic rules under the FAA largely to mitigate the claw-back of equalization payments experienced by Saskatchewan in relation to its potash revenues; however, the generic inclusion rate was also extended to offshore resource revenues of both Nova Scotia and Newfoundland[19]. The generic rules provided for a reduced 70 per cent rate of inclusion of offshore revenues in the revenue sources under the FAA.

The generic rules of the equalization formula existed concurrent with and did not supersede the equalization offset payment under the Offshore Accord. This was clear from section 4(11) of the FAA:

"In order for [70 per cent inclusion rate] to apply in respect of the offshore minerals revenue …, a province that is eligible for a fiscal equalization offset payment in the fiscal year under the *Canada–Nova Scotia Offshore Petroleum Resources Accord Implementation Act* … in respect of a fiscal year beginning on or after April 1, 1993 *shall make an election*, in the prescribed manner, before the end of the calendar year ending in the fiscal year."(Emphasis added)

The FAA required Nova Scotia to elect the application of the generic rules, failing which it received the equalization offset payments under the Offshore Accord. The generic rules of the FAA as they applied to Nova Scotia's offshore revenues were repealed concurrent with the Budget Implementation Act, 2004.

Although the generic rules did not affect Canada's obligation to make offset payments to Nova Scotia as set out in the 1986 accord, the rules reinforced the coupling of equalization and offshore accords in the minds of the public. This confusion continues today, as is evidenced by the many submissions to the panel that assert that the 1986 accord as supplemented by the 2005 agreement undermines the Equalization program.

18 Budget Implementation Act, 2004, S.C. C-30, Part 3, Section 8.

19 Of note, since the Offshore Accord is a bilateral agreement, it may be amended only by the parties. Canada cannot fulfil its equalization offset obligation under the Offshore Accord by amending the FAA. The procedure to amend the Offshore Accord is set out in the Canada–Nova Scotia Offshore Petroleum Resources Accord Implementation Act:
"The Government of Canada … may jointly with the Government of Nova Scotia, amend the Accord from time to time."

9. Achieving the Offshore Accord Objectives

The 1986 accord included an evergreen clause requiring the parties to periodically review the objectives of the 1986 accord. One of these objectives was "to recognize the right of Nova Scotia to be the principal beneficiary of the Petroleum Resources in the Offshore Area …"

Invoking the evergreen clause, the Premier of Nova Scotia launched the Campaign for Fiscal Fairness in January 2001 to ensure that the policy as well as the legal commitments of the Nova Scotia Offshore Accord were realized and that Nova Scotia received the lion's share of the offshore revenues (as promised in the 1982 agreement) until the oil and gas development closed the gap on regional disparity and Nova Scotia became a "have" province.

In June 2002, Nova Scotia initiated a formal review of the principal beneficiary objective of the 1986 accord. Eventually the parties signed the *Arrangement between the Government of Canada and the Government of Nova Scotia on Offshore Revenues* on February 14, 2005 (2005 agreement). The 2005 agreement supplements but does not replace the 1986 accord, which continues in full force and effect between Canada and Nova Scotia. The 2005 agreement deals specifically and exclusively with the equalization offset payments in Article 27 of the 1986 accord, a provision that was critical to Nova Scotia's decision to sign the 1986 accord and set aside its jurisdictional claim.

The 2005 agreement provides that from 2006–2007 to 2011–2012 the annual offset payments that Canada will pay Nova Scotia "shall be equal to 100 per cent of any reductions in Equalization payments resulting from offshore resource revenues." The annual offset payments will continue from 2012–2013 to 2019–2020, provided Nova Scotia qualifies for equalization in either 2010–2011 or 2011–2012 and its per capita net debt is not lower than that of at least four other provinces. "No later than March 31, 2019, *and consistent with the existing review provisions in the 1986 [Accord]*, the parties agree to review the current arrangement." (Emphasis added)

The 2005 agreement is supplemental to the 1986 accord. Underlying both the 1986 accord and its predecessor, the 1982 agreement, was the agreement by Nova Scotia to set aside its constitutional claim of jurisdiction in consideration of the agreements by Canada, *inter alia*, on joint management and revenue sharing of the Nova Scotia offshore. This included a specific understanding that Canada would

not undermine the Offshore Accord with Nova Scotia on revenue sharing through reliance on the equalization formula contained in the FAA. Rather than effectively neutralizing through claw-back the revenues to be shared with Nova Scotia as set out in the 1982 agreement or the revenues ceded to Nova Scotia in the 1986 accord, Canada agreed to make offset payments equal to the claw-back in Nova Scotia's equalization payments.

In announcing the 2005 agreement, the Office of the Prime Minister was clear that the agreement remained outside the equalization program and rooted in the Government of Canada's constitutional mandate for economic development (and nation building), stating:

> *"No amendments to the Canada–Nova Scotia Offshore Petroleum Resources Accord or equalization legislation will be required. Payments under the offshore revenue agreements will be made separately from [this accord] and the new Equalization-Territorial Formula Financing framework."*

In the same statement, Finance Minister Ralph Goodale commented on the unique economic considerations relating to the agreement, saying:

> *"I am delighted these intense negotiations have resulted in an arrangement that addresses the unique economic situation of Nova Scotia while being fair to all Canadians."*

The 2005 agreement continues the original revenue-sharing arrangements of the 1986 accord until Nova Scotia reduces its economic disparity as originally intended by both the 1982 agreement and the 1986 accord. The renewal provisions of the 2005 agreement underscore the association between the Nova Scotia Offshore Accord and the section 36(1)(b) regional development and opportunity principle. While economic disparity continues to be measured by reference to equalization payments, this is merely the original tool used to assess the progress Nova Scotia is making compared to other provinces as a result of the economic development of its offshore. In the 2005 agreement another measure has been introduced, that of net per capita debt, a benchmark also intended to measure Nova Scotia's economic development progress.

10. Arguments by Others

With the exception of the submission by the Government of Saskatchewan, many of the written submissions to the panel criticize the accord as a one-off[20] deal that was designed to undermine the principles of equalization. These submissions overlook the historical context of the agreement on offshore resources. These critics say that the main purpose, or certainly an important purpose, of the Nova Scotia Offshore Accord was to provide equalization payments to Nova Scotia outside of the equalization formula. This is incorrect. The Offshore Accord's purpose was to overcome the constitutional impasse over offshore jurisdiction through agreement on, in particular, the joint management and the sharing of revenues from the offshore. In so doing, both Canada and Nova Scotia believed a roadblock to the development of Nova Scotia's offshore would be eliminated and Nova Scotia would receive significant offshore revenues and see sustainable economic development.

The fact that the Equalization program then in place would have clawed back the offshore revenues was a major impediment to Nova Scotia's decision to set aside its jurisdictional claim. The equalization offset payment was a critical component of Canada's offer that Nova Scotia relied upon and that resulted in the agreement to share jurisdiction by way of a joint management regime and revenue sharing. But for the equalization offset payments, the fundamental agreement on revenue sharing in the Offshore Accord would have been undermined by the equalization program.

20 *Equalization Reform That Works: Taking seriously the idea that incentives matter*, AIMS, July 20, 2005, p. 9:
Over the years a number of one-off deals have been *designed to correct perceived inequities* and flaws in the equalization formula. The Atlantic Accord and Canada–Nova Scotia Accord have effectively circumvented the equalization formula's treatment of non-renewable natural resources as royalties … Fairness demands that the equalization formula work without additional deals and agreements *designed to circumvent the rules of the program.*"(Emphasis added)

New Brunswick's Perspective on the Equalization Program, July 2005, p. 4:
"The recent offshore deals, and other special arrangements, have served to exacerbate fiscal disparities that the Equalization Program is designed to reduce. This is *inconsistent with the spirit and intent of the program* and the principle of equalization in general. Bilateral arrangements outside the program should not undermine the Equalization Program." (Emphasis added)

Submission to the Expert Panel on Equalization, Ronald H. Neumann, July 2005, p. 18:
"Finally, it must be noted that the ad hoc measures put in place by the federal government over the past two years are *more troubling to the integrity of the program* than the census adjustment forgiveness and repayment schedules of the past."(Emphasis added)

Key Questions on Equalization: A Discussion, L. S. Wilson, June 2005, p. 25:
"Much of the recent criticism of the federal government has been around the *'backroom deals' which have been made within the framework*, if not the existing rules of the equalization program." (Emphasis added.)

Saskatchewan, while coming closest to recognizing that the accords[21], including the provisions on revenue sharing, flowed out of the dispute over ownership of the offshore, may have mischaracterized the accord by saying that it "recognizes that non-renewable resources are one-time in nature and should be retained by the rightful provincial owners of those resources to strengthen their economy." Nova Scotia does not argue that the Offshore Accord is justified based on a depleting non-renewable resource; rather Nova Scotia says that it agreed to set aside the jurisdictional debate in consideration of the joint management regime and the sharing of offshore revenues. In pursuing its full rights to the latter, Nova Scotia has pushed to ensure that it is the principal beneficiary of those offshore revenues until it achieves a specified fiscal capacity. The 2005 agreement is the result of this effort. It ensures that the agreement on revenue sharing that was an important component to Nova Scotia setting aside the constitutional dispute is fulfilled by Canada.

11. Changes in the Inclusion Rate for Offshore Revenues

The Expert Panel refined its mandate in a paper published March 1, 2005, by identifying the key issues the panel proposed to focus on. With respect to the *Canada–Newfoundland Atlantic Accord* (1985) and the *Canada–Nova Scotia Offshore Petroleum Resources Accord* (1986) and the related agreements signed on February 14, 2005, the panel noted that its recommendations, particularly with respect to "potential changes to the treatment of offshore revenues in Equalization,"[22] could have the following effect:

> *"Should a new allocation formula exclude* more *than the current 30 per cent of offshore revenues (the current "generic" solution under Equalization), both provinces would experience smaller Equalization claw-backs, and smaller offset payments would be owed. The two provinces would obtain a larger share of the fixed Equalization envelope, the other receiving provinces would get less, and the federal government would owe them smaller offset payments. Conversely, should a new formula exclude* less *than the current 30 per cent of offshore revenues, the two provinces would obtain a lower share of Equalization, other provinces would get more, and the federal government would owe larger offsets."*[23]

21 *Equalization Reform, A Fair Deal for Saskatchewan*, June 2005, p. 11:
"These Accords gave Newfoundland and Labrador in 1985 and Nova Scotia in 1986 the right to manage and tax offshore energy resources as if they owned them. The Accords also contained special provisions to significantly limit Equalization claw backs on revenues accruing from the development of the offshore energy resources."

22 *Key Issues for the Review of Equalization and Territorial Formula Financing*, March 31, 2005, at p. 20.

23 Supra.

Since the publication by the panel of its key issues paper and its stated interest in the effect of a change in inclusion rate from 70 per cent, the FAA has been amended to delete the generic inclusion rate of 70 per cent for offshore revenues.

However, should the Expert Panel recommend a change in the inclusion rate for offshore revenues in the equalization formula, Nova Scotia would not be affected, because Nova Scotia will receive equalization offset payments from Canada under the Nova Scotia Offshore Accord equal to 100 per cent of whatever claw-back it experiences under the equalization formula.

In effect, the Nova Scotia Offshore Accord and the equalization offset payments required under the Nova Scotia Offshore Accord are insulated from any changes to the Equalization program, including any changes to the inclusion rate for offshore revenues. In order for Nova Scotia to be affected, the Expert Panel would need to go so far as to recommend that Canada, through legislation or otherwise, directly target and breach the equalization offset payment provisions of the Nova Scotia Offshore Accord. Not only would such a recommendation by the panel be outside of its mandate, but it would also place Canada in the untenable position of undermining or neutralizing the recently finalized the revenue-sharing arrangements set out in the 2005 agreement, an act that would call into question the *bona fides* and honour of the federal Crown.

12. Importance of Bilateral Agreements

The historical context upon which our country has been built is marked by bilateral agreements for the benefit of one region or the other, and Canada has repeatedly established its authority to make such agreements outside the Equalization program. Other provinces have benefited from this practice.

One example is the federal legislation that supported the 1965 Auto Pact and eliminated trade tariffs on automobiles, either manufactured or sold in Canada and the United States. Between 1965 and 2002, the number of vehicles manufactured in Canada (primarily Ontario) increased from 846,000 to 2.6 million units. Associated employment increased from 75,000 people to 491,000. The Canadian automotive industry accounted for 12 per cent of our nation's gross domestic product in 2002.

Here a particular sector benefited from a federal decision to forego customary revenues from trade tariffs as a method of encouraging economic development in a particular region. There is no doubt that the fiscal capacity of Ontario and of the nation has benefited enormously from this decision.

In another instance, in October 2004, Canada exercised its prerogative under section 36 (1)(b) in the form of a government-secured loan guarantee of $1.5 billion provided to Quebec-based Bombardier. In the result, this secured jobs and economic development for Quebec.

In these instances, the federal government is within its constitutional authority to conclude bilateral agreements or to pass appropriate legislation to achieve its constitutional obligations. In these instances, the objectives of economic development are front and centre. In these cases, the individual provinces enjoy the benefits that flow, either directly or indirectly, from the federal actions. In these cases, the country as a whole is strengthened.

More recently on May 7, 2005, Premier McGuinty negotiated a five-year agreement for $5.75 billion in federal investments to strengthen Ontario's role as the economic engine of Canada. This bilateral agreement between Canada and Ontario clearly spells out that the agreement does not preclude subsequent agreements between Ontario and Canada and, just as importantly, states:

> *"The funding in this agreement is in addition to and does not otherwise affect existing bilateral Canada-Ontario agreements or multilateral federal-provincial-territorial agreements, unless so agreed by both parties …"*

Nova Scotia encourages Canada to continue in this approach as it deals with the redistribution of record surpluses, and having already fixed its fiscal contribution to equalization over the next 10 years.

However, Nova Scotia sees its Nova Scotia Offshore Accord as very different from these other bilateral agreements predicated on economic development. While sustainable economic development is an important outcome of the successful development of its offshore resources, the Nova Scotia Offshore Accord arose out of the agreement by Nova Scotia to set aside its jurisdictional claim to the management and revenues from its offshore oil and gas. One of the fundamental terms was that Nova Scotia would share in the offshore revenues and that such sharing would not

be undermined by the workings of the equalization formula. As a fundamental term of Nova Scotia's agreement with Canada, Nova Scotia submits that the Expert Panel does not have the mandate, directly or indirectly through changes to the equalization formula, to undermine the bilateral agreement between Canada and Nova Scotia on the revenue sharing from Nova Scotia's offshore resources.

The 1982 agreement, the 1986 accord, and the 2005 agreement are, thus, fundamentally different from bilateral agreements involving fiscal transfers for specific programs. Rather, they represent the stages to resolution of the issue of over development of Nova Scotia's offshore petroleum resources.

13. Recommendations by Nova Scotia

In conclusion, the genesis of the Nova Scotia Offshore Accord was the resolution of the constitutional dispute regarding jurisdiction over the offshore. And, it was in consideration of this agreement by Canada to ensure that Nova Scotia was the principal beneficiary of the offshore revenues that Nova Scotia set aside its claim to jurisdiction over the offshore petroleum revenues and entered into the 1982 agreement and, subsequently, the 1986 accord as supplemented by the 2005 agreement. In setting aside the claim to jurisdiction, Nova Scotia gave up the possibility of sole control of development of the resource and otherwise acted in reliance on its rights as principal beneficiary.

The only connection with the Equalization program is the need for equalization offset payments by Canada to Nova Scotia. These protect the agreement reached by Canada and Nova Scotia on offshore revenue sharing from being undermined by claw-back under the equalization formula.

Any recommendations by the panel to change the rate of inclusion in the equalization formula for Nova Scotia's offshore resource revenues would not affect the total payments by Canada to Nova Scotia for the first eight eight-year period. Under the 2005 agreement, whatever percentage of Nova Scotia's offshore revenues that would be included in the equalization formula would be fully compensated by Canada through equalization offset payments under the Nova Scotia Offshore Accord. The compensating payments made by Canada to Nova Scotia, while calculated by reference to the equalization formula, are entirely separate from and outside of the equalization formula and process.

Any recommendations by the Expert Panel for changes to the Equalization program should not undermine the principles of the agreement set out in the Nova Scotia Offshore Accord. This would put Canada in the untenable position of having recently finalized the revenue-sharing arrangements for Nova Scotia's offshore through the 2005 agreement and then being faced with a recommendation by its own advisory panel to make changes to the equalization formula that would undermine or neutralize the 2005 agreement. Any such changes by Canada would bring into question its *bona fides* and the honour of the Crown.

It is important to emphasize that Nova Scotia's offshore resources revenues are included in the Equalization program and that Nova Scotia fully supports the inclusion of all resource revenues, whether onshore or offshore, in the program. Their exclusion would seriously undermine the spirit and intent of the Equalization program by significantly understating the revenues of certain resource-rich provinces. This, in turn, would significantly reduce equalized revenues and would lead to increased disparity in the levels of public services in the receiving provinces, a result that would be at odds with the constitutional principle of section 36(2).

The Nova Scotia Offshore Accord settled a constitutional dispute over jurisdiction and therefore is fundamentally different from most bilateral agreements. Nevertheless, Nova Scotia recommends that the panel refrain from extending its mandate into the realm of section 36(1). Nova Scotia believes that Canada should not be deprived of its right to conclude bilateral agreements with the provinces and territories simply because such agreements have a direct or indirect effect on fiscal capacity. Otherwise, Canada's hands will be tied in achieving its constitutional commitments other than the equalization principle set out in section 36(2). Important bilateral agreements will be discouraged.[24]

The future Equalization program not only must tolerate but must embrace bilateral agreements between Canada and the provinces as a means of resolving disputes, including constitutional disputes, of the sort encountered by Canada and Nova Scotia on jurisdiction over the offshore. Bilateral agreements are essential to effective federal-provincial relations.

24 In his remarks to the Expert Panel on September 9, 2005, Premier John Hamm referred to the 1965 Auto Pact and the $1.5-billion loan guarantee to Quebec-based Bombardier Inc. as illustrations of the need for Canada to "pursue reasonable adjustments outside equalization that recognize unique circumstances and potential … As I have stated, all provinces negotiate bilateral agreements with the Federal Government for differing objectives such as auto plants, highways, BSE and others. These federal contributions are not included in the calculation of fiscal capacity for purposes of determining equalization, nor should they be."

Premier Hamm summarized Nova Scotia's position in his concluding remarks to the Expert Panel on September 9, 2005:

> *"The Government of Canada's commitment that these resource revenues will be dealt with outside of equalization is grounded in the Constitution and established outside the program and, therefore, the Accords are not open to review by the Panel.*
>
> *The Government has the right to reach bilateral agreements with any province, and has done so numerous times outside of equalization. The Accords are one more such agreement and should not be considered by the Panel.*
>
> *Any effort that erodes the benefits the Accords are intended to deliver to Nova Scotians, after 22 years of effort, are outside the Constitution, and outside the law as expressed in the Accords, and contrary to the intentions of the Government as expressed by four Prime Ministers."*