

4-1-2001

Securing Assets of Oil and Gas Projects Offshore Nova Scotia

Robert W. Carmichael
Cox Hanson O'Reilly Matheson

Follow this and additional works at: <https://digitalcommons.schulichlaw.dal.ca/dlj>



Part of the [Oil, Gas, and Mineral Law Commons](#)

Recommended Citation

Robert W. Carmichael, "Securing Assets of Oil and Gas Projects Offshore Nova Scotia" (2001) 24:1 Dal LJ 279.

This Article is brought to you for free and open access by the Journals at Schulich Law Scholars. It has been accepted for inclusion in Dalhousie Law Journal by an authorized editor of Schulich Law Scholars. For more information, please contact hannah.steeves@dal.ca.

Offshore oil and gas projects sometimes require financing, and project financing usually requires the taking of security in project assets. In this article, the author examines the legislative framework comprised of the traditional provincial and federal security legislation and the specialized Nova Scotia Accord Acts to determine that there is presently no effective regime in place for taking security in many types of assets of offshore oil and gas projects.

Les opérations pétrolières et gazières extracôtières doivent être financées. Or, le financement de projets semblables nécessite la prise en garantie de certains éléments d'actif de l'opération. Dans cet article, l'auteur examine la législation en vigueur, notamment les lois provinciales et fédérales concernant les garanties de même que les Nova Scotia Accord Acts (lois de la Nouvelle-Écosse sur les ententes). Il en conclut qu'il n'existe actuellement aucun régime législatif adéquat régissant la prise en garantie de nombreux éléments d'actif d'opérations pétrolières et gazières extracôtières.

* Robert W. Carmichael is a partner in the Halifax office of Cox Hanson O'Reilly Matheson. The assistance of Megan Sullivan is gratefully acknowledged.

Introduction

I. *Overview of Legislation*

1. *Nova Scotia Accord Acts*
2. *Petroleum Resources Removal Permit Act*
3. *Personal Property Security Act*
4. *Oceans Act*
5. *Bank Act*
6. *Canada Shipping Act*

II. *Project Assets*

III. *The Project Agreements*

1. *Overview of Project Agreements*
2. *Security on Project Agreements*

IV. *Exploration and Production Licences*

V. *Permanent Offshore Marine Installations*

1. *Bank Act Security on Marine Installations*
2. *Registration of Security in Marine Installations pursuant to the Personal Property Security Act*

VI. *Movable Drilling and Production Units, Ships and Vessels*

1. *Mortgages Pursuant to Canada Shipping Act*
2. *Registering Security Interests on Movable Personal Property under the Personal Property Security Act*

VII. *Production*

1. *Bank Act Security on Production*
2. *Registration of Security Interests in Production pursuant to the Personal Property Security Act*

VIII. *Land-Based Processing Facilities*

Introduction

This article examines issues relating to securing assets of oil and gas projects offshore Nova Scotia. Its intent is to provide a general overview of the legal and contractual frameworks in which offshore project financings will occur, having regard to the types of assets that would typically be considered for security in financing an offshore oil and gas project. This will involve a discussion of the legislative framework governing security interests in the assets of offshore projects and the gaps that exist in the current legislative regime. It is not my intent to analyze in detail priorities or enforcement issues. Those matters, while obviously important, are beyond the scope of this article.¹

In 1990 the governments of Canada and the Province of Nova Scotia enacted legislation to give effect to a 1986 inter-governmental accord on offshore petroleum resources. The *Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation (Nova Scotia) Act*² and the *Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act*³ provide the basic legislative framework governing the exploration and production of petroleum resources in the area offshore Nova Scotia. The regime established by the *Nova Scotia Accord Acts* is one supported by the legislation of both levels of government. But the *Nova Scotia Accord Acts* do not establish a comprehensive regime respecting security interests in assets used to produce oil and gas in offshore areas. This means that, for most offshore assets, it is necessary to consider the extent to which traditional security legislation (personal property security legislation, the *Bank Act*,⁴ and so on) apply.

Taken as a whole, the federal and provincial security statutes provide a reasonably comprehensive, albeit patchwork, regime governing security in almost every conceivable type of collateral. Of all the security legislation in Canada, the provincial personal property security statutes are the most comprehensive and far reaching in scope. They are the cornerstone of today's system of taking and enforcing security interests

1. A number of issues relating to priorities and realization under the *Bank Act*, S.C. 1991, c. 46, and *Canada Shipping Act*, R.S.C. 1985, c. S-9, as am., as well as issues relating to the inter-relationship of federal and provincial security laws are discussed in a recent article by R.J. Wood, "The Nature and Definition of Federal Security Interests" (2000) 34 Can. Bus. L.J. 65.

2. S.N.S. 1987, c. 3 [hereinafter *Nova Scotia Accord Act* (Nova Scotia)].

3. S.C. 1988, c. 28 [hereinafter *Nova Scotia Accord Act* (Canada)]. The *Nova Scotia Accord Act* (Nova Scotia) and the *Nova Scotia Accord Act* (Canada) are collectively referred to as the *Nova Scotia Accord Acts*.

4. *Supra* note 1.

in assets in this country. In terms of assets located in the area offshore Nova Scotia, it is a fundamental question whether the province's property security legislation applies.

The *Nova Scotia Accord Acts* leave that fundamental issue unresolved. The *Acts* are silent as to whether Nova Scotia personal property law applies in the offshore. In fact, there is currently no federal law that prescribes that the province's personal property security law applies offshore. This is significant because, although the question of which level of government has jurisdictional authority over the area offshore Nova Scotia has never been specifically adjudicated by the Supreme Court of Canada, the court has ruled that the federal government has exclusive legislative authority for areas comprising the continental shelf offshore British Columbia and Newfoundland.⁵ It is therefore doubtful that the laws of Nova Scotia, and in particular its personal property security laws, extend to the offshore area in the absence of federal legislation making those laws applicable.

I. Overview Of Legislation

To begin, there are a handful of statutes relevant to taking security on assets offshore. These include (a) the *Nova Scotia Accord Acts*, (b) the *Petroleum Resources Removal Permit Act*⁶ (Nova Scotia), (c) the *Personal Property Security Act*⁷ (Nova Scotia), (d) the *Oceans Act*⁸ (Canada), (e) the *Bank Act* (Canada), and (f) the *Canada Shipping Act*⁹ (Canada).

5. See *Reference re Offshore Mineral Rights of British Columbia*, [1967] S.C.R. 792; and *Reference re Seabed and Subsoil of the Continental Shelf Offshore Newfoundland*, [1984] 1 S.C.R. 86 [hereinafter *Ref. re Newfoundland*]. The *Acts* skirt the issue by stating that nothing in the legislation affects the rights or legislative jurisdiction of either government. *Nova Scotia Accord Act* (Nova Scotia) *supra* note 2, s. 3; and *Nova Scotia Accord Act* (Canada), *supra* note 3, s. 3.

6. S.N.S. 1999, c. 7 [hereinafter *Removal Permit Act*].

7. S.N.S. 1995-96, c. 13 [hereinafter *PPSA*].

8. S.C. 1996, c. 31.

9. *Supra* note 1. There were substantial amendments to the *Canada Shipping Act* under S.C. 1998, c. 16 (assented to 11 June 1998). On June 8, 2000, Bill C-35 (*An Act Respecting Shipping and Navigation*, 2d Sess., 36th Parl., 2000) received first reading in the House of Commons. The bill contains the *Canada Shipping Act, 2000* which, if enacted, will substantially overhaul the *Canada Shipping Act, ibid.*

1. *Nova Scotia Accord Acts*

The *Nova Scotia Accord Acts* govern the exploration for and production of petroleum in the offshore area. The *Acts* establish the Canada-Nova Scotia Offshore Petroleum Board (CNSOPB or the Board).¹⁰ The mandate of the Board includes the power to issue “interests” which are defined as exploration licences, significant discovery licences (SDLs) and production licences.¹¹

An exploration licence gives the licence holder the right to explore and drill for petroleum, the right to develop the offshore area covered by the licence in order to produce petroleum and, subject to complying with the other requirements of the *Act*, the right to obtain a production licence.¹² Similar rights are conferred by significant discovery licences issued in respect of portions of the offshore area that have been declared by the Board to be significant discovery areas.¹³ A production licence confers the same rights as an exploration licence or significant discovery licence. In addition, a production licence vests in the licence holder title to the petroleum produced pursuant to it.¹⁴ Until produced, title to petroleum *in situ* remains with the Crown.

The *Nova Scotia Accord Acts* establish a public registry system¹⁵ maintained by the CNSOPB (the CNSOPB Registry) for recording rights in interests (*i.e.*, exploration and production licences and SDLs) and transfers of interests and shares therein including assignments by way of security and security taken under s. 426 of the *Bank Act*.¹⁶ The *Nova Scotia Accord Acts* do not provide a regime for registering security interests in tangible offshore project assets (wells, production platforms, gathering lines, transportation pipelines and such) except to the extent security can be taken pursuant to s. 426. This means that federal and provincial security legislation must be considered.

In assessing the extent to which federal and provincial legislation applies in the offshore, it is important to bear in mind that the offshore area, for the most part, is not considered to be within the geographic limits of any province.¹⁷ The analysis here requires an understanding of two

10. *Nova Scotia Accord Act* (Nova Scotia), *supra* note 2, s. 9; and federal *Nova Scotia Accord Act* (Canada), *supra* note 3, s. 9.

11. See *Nova Scotia Accord Act* (Nova Scotia), *ibid.*, ss. 54(g), 63.

12. *Ibid.*, s. 71.

13. *Ibid.*, s. 78.

14. *Ibid.*, s. 86.

15. See *Nova Scotia Accord Act* (Nova Scotia), *ibid.*, ss. 104-120; and *Nova Scotia Accord Act* (Canada), *supra* note 3, ss. 105-121.

16. For a description of s. 426 of the *Bank Act*, see Part I, Section 5, below.

17. *Supra* note 5 and accompanying text.

significant terms used in the *Nova Scotia Accord Acts*: (i) the “offshore area,” and (ii) the “Nova Scotia lands.”

The federal and provincial *Nova Scotia Accord Acts* are substantially the same, however, the mirror does not cast a perfect reflection. The federal *Act* applies within “the offshore area.”¹⁸ The provincial *Act* applies to the “Nova Scotia lands” within the offshore area.¹⁹ The “offshore area” is defined in both *Acts* by a detailed metes and bounds description contained in Schedule I of the *Nova Scotia Accord Acts*. Essentially the offshore area is the land and submarine areas beginning at the low water mark around the perimeter of the land mass of the province of Nova Scotia and extending generally east a distance of 200 nautical miles offshore to the limit of Canadian resource jurisdiction. It includes the portion of the continental shelf to the east of Nova Scotia.²⁰

“Nova Scotia lands” is defined in the provincial *Act* but not the federal one. Subsection 2(p) of the *Nova Scotia Accord Act* (Nova Scotia) contains the following definition of “Nova Scotia lands”:²¹

“Nova Scotia lands” mean:

- (i) Sable Island, and
- (ii) those submarine areas that belong to Her Majesty in right of the Province or in respect of which Her Majesty in right of the Province has the right to dispose of or exploit the natural resources, and that are within the offshore area.

The distinction between the “Nova Scotia lands” and the “offshore area” is significant because Nova Scotia has asserted jurisdiction with respect to the “Nova Scotia lands” by enacting legislation permitting security to be taken over assets located in the area comprising the “Nova Scotia lands.” The province asserts this jurisdiction under the *Removal Permit Act*, which was proclaimed in force June 17, 1999. The main purpose of this statute is to promote the development of a petro-chemical industry in Nova Scotia by requiring producers to obtain a permit to remove certain petroleum products from the province, but s. 18 provides that a lender or secured creditor may take security on real and personal property located in the Nova Scotia lands.

18. *Nova Scotia Accord Act* (Canada), *supra* note 3, s. 8.

19. *Nova Scotia Accord Act* (Nova Scotia), *supra* note 2, s. 8.

20. The boundary between the offshore area of Nova Scotia and the offshore area of Newfoundland which splits the Laurentian Basin is currently the subject of a boundary dispute between the two provinces. In the offshore area generally east of Cape Breton and south of Newfoundland, the Nova Scotia and Newfoundland offshore areas are interrupted by an area controlled by France surrounding the islands of St. Pierre & Miquelon and extending down a corridor south of those islands approximately 20 kilometres wide and 300 kilometres long.

21. *Supra* note 2, s. 2(p).

2. *Petroleum Resources Removal Permit Act*

Subsection 18(2) of the *Removal Permit Act* states that the *Personal Property Security Act* of Nova Scotia applies to security interests in personal property “in or upon or otherwise relating to”²² the Nova Scotia lands. Subsection 18(3) states that the *Registry Act*²³ (Nova Scotia) applies to security interests in real property. On its face, the relevance of s. 18 in the context of taking security on the assets of offshore oil and gas projects would seem obvious. But there are constitutional issues which cast doubt on the validity and scope of the *Removal Permit Act*, at least to the extent it purports to extend Nova Scotia security law to the offshore.

To put the issues in context, two significant Supreme Court of Canada decisions dealing with legislative jurisdiction over offshore natural resources must be considered. The first is *Reference re Offshore Mineral Rights of British Columbia*.²⁴ There the court was asked if the natural resources of the seabed and subsoil on the west coast belonged to Canada or British Columbia, whether either had the right to explore or exploit that land and finally, whether either had legislative jurisdiction in relation to the land. The court answered unanimously in favour of Canada on all three questions.

As with the territorial sea, so with the continental shelf. There are two reasons why British Columbia lacks the right to explore and exploit and lacks legislative jurisdiction:

- (1) The continental shelf is outside the boundaries of British Columbia, and
- (2) Canada is the sovereign state which will be recognized by international law as having the rights stated in the Convention of 1958, and it is Canada, not the Province of British Columbia, that will have to answer the claims of other members of the international community for breach of the obligations and responsibilities imposed by the Convention.

There is no historical, legal or constitutional basis upon which the Province of British Columbia could claim the right to explore and exploit or claim legislative jurisdiction over the resources of the continental shelf.²⁵

The issues were revisited in *Reference re Seabed and Subsoil of Continental Shelf Offshore Newfoundland*.²⁶ The Supreme Court was asked two questions: whether Canada or Newfoundland, as regards the natural resources on the continental shelf, had the right to explore and

22. *Supra* note 6, s. 18(2).

23. R.S.N.S. 1989, c. 392.

24. *Supra* note 5.

25. *Ibid.* at 821.

26. *Supra* note 5.

exploit the resources, and, whether Canada or Newfoundland had the legislative jurisdiction to make laws in relation to the exploration or exploitation of such resources. In an attempt to distinguish the earlier British Columbia decision, Newfoundland argued that it had a different historical and constitutional position than British Columbia. The court rejected the argument and again answered in favour of Canada on both questions, stating that the right to explore and exploit the resources of the continental shelf were rights granted to Canada by international law as a coastal state.

At international law, then, the continental shelf off Newfoundland is outside the territory of the nation state of Canada. Since, as a matter of municipal law, neither Canada nor Newfoundland purports to claim anything more than international law recognizes, we are here concerned with an area outside the boundaries of either Newfoundland or Canada. In other words, we are concerned with extraterritorial rights.²⁷

Furthermore, the court determined that Newfoundland's legislative competence was confined to legislation operating within its provincial boundaries, like all other Canadian provinces.²⁸ The court's view was that the continental shelf was outside Newfoundland's boundaries (and the boundaries of Canada for that matter) and since the continental shelf was outside the territory of Newfoundland, it could not fall within the scope of any of the provincial powers contained in s. 92 of the *Constitution Act, 1867*.²⁹ Legislative jurisdiction rested with Canada under its residual peace, order, and good government powers.³⁰

These decisions are obviously relevant to any debate as to the scope of Nova Scotia's *Removal Permit Act*. A province cannot make laws which extend beyond its own boundaries. That principle seems to have been recognized by Nova Scotia in enacting the *Removal Permit Act*. That legislation applies only to petroleum "produced in the province."³¹ Of course this raises the question whether petroleum produced offshore is

27. *Ibid.* at 97.

28. The Supreme Court said this: "Newfoundland's legislative competence, like that of all the other provinces, is confined to legislation operating within the provinces." *Ibid.* at 127-28.

29. *Constitution Act, 1867* (U.K.), 30 & 31 Vict., c. 3, s. 92.

30. In the Newfoundland case, *Ref. re Newfoundland*, *supra* note 5 at 127, the court said:

The conclusion that Canada has the right to explore and exploit in the continental shelf leads easily to the conclusion that Canada has legislative jurisdiction. There is nothing in s. 92 of the *Constitution Act, 1867* which could confer legislative jurisdiction upon Newfoundland in respect of such rights held by Canada. Legislative jurisdiction falls to Canada under the peace, order, and good government power in its residual capacity.

31. *Removal Permit Act*, *supra* note 6, s. 4.

produced “in the province” of Nova Scotia. It is doubtful, having regard to the Supreme Court’s decision in the Newfoundland case, that the continental shelf is within the geographic boundaries of any province. In the Newfoundland case, the Supreme Court stated unequivocally that continental shelf rights are “extraterritorial” rights³² and that the “first nine Canadian provinces . . . never gained extraterritorial legislative competence. . . .”³³ It made no difference in the Supreme Court’s analysis as to when the provinces joined Confederation.

There is then a fundamental difficulty with the *Removal Permit Act* (as it relates to taking security on offshore assets). Section 18 of the *Act* applies only to personal property or real property located in “Nova Scotia lands.” “Nova Scotia lands” is defined in the *Act*³⁴ by reference to its definition in the *Nova Scotia Accord Act* (Nova Scotia) (*i.e.* Sable Island and any other submarine areas in the offshore owned by the province or in respect of which the province has the right to exploit natural resources).³⁵ The problem is that the *Nova Scotia Accord Acts* do not establish which, if any, areas in the offshore belong to the province or are subject to its resource exploitation rights. The Supreme Court decisions in the Newfoundland and British Columbia cases cast serious doubt on whether the provinces have any legislative authority in the offshore areas on the continental shelf.

The point of all of this is that if it should be determined that the offshore area and its natural resources belong to the federal Crown and not the Province of Nova Scotia, then s. 18 of the Nova Scotia’s *Removal Permit Act* will not extend to the offshore area and the registration, attachment, and perfection rules under the province’s *PPSA* will not apply to tangible personal property located in the offshore.³⁶

32. *Ref. re Newfoundland*, *supra* note 5 at 99.

33. *Ibid.* at 103.

34. *Removal Permit Act*, *supra* note 6, s. 3(j).

35. *Supra* note 2, s. 2(p).

36. This would be the case for marine installations constructed offshore although the *PPSA* may be applicable in respect of goods subsequently brought into the province of Nova Scotia. The issue of whether the Province of Nova Scotia has any rights to natural resources in any part of the offshore (the answer to which determines the scope of the application of s. 18 of the *Removal Permit Act*) could conceivably be raised by a creditor in the context of a priorities dispute relating to offshore assets. The problem may be solved before then by remedial federal legislation making provincial law applicable to security taken on real and personal property in the offshore. As of the time of this article (August 2001) that has not happened, there are no applicable federal regulations.

3. *Personal Property Security Act*

Most assets that would typically be the subject of security for a financing of an offshore oil and gas project, other than real estate interests, would fall within the definition of “personal property” in the *PPSA*.³⁷ This would include assignments of contractual rights (for instance under project agreements, sales agreements or transportation agreements), onshore and offshore installations that are equipment or fixtures (which potentially includes offshore production platform facilities, pipelines and storage facilities), and the production and the proceeds or accounts receivable from the sale of production.³⁸ In many cases, there is no federal security legislation that would govern security interests in those types of assets. It is therefore vitally important, for the sake of an appropriate and comprehensive regime for registering and enforcing security interests in assets located in the area offshore Nova Scotia, that the province’s *PPSA* applies in the offshore. It is likely that, as a matter of constitutional law, federal legislation is required for that purpose.

4. *Oceans Act*

The *Oceans Act* applies to Canada’s territorial sea (the area offshore to a distance of 12 nautical miles) and the continental shelf. The continental shelf is by definition the seabed and subsoil of the submarine areas beyond the territorial sea to a distance of 200 nautical miles offshore.³⁹ Subject to any federal regulations prescribing that provincial laws apply, s. 20(1) provides that federal laws apply to marine installations and structures attached or anchored to the continental shelf in connection with exploration or exploitation of mineral resources.⁴⁰ Marine installations and structures, as defined in the *Act*, include many of the physical exploration and production assets that would typically be considered for security to support a financing of an offshore oil and gas project. Specifically, marine installations or structures under the *Oceans Act* include, but are not limited to, any offshore drilling unit, production platform, subsea installation, pumping station, living accommodation, storage structure or loading or landing platform.⁴¹

37. Under the *PPSA*, *supra* note 7, s. 2(ad), the term “personal property” means goods (defined under s. 2(u), this includes tangible personal property including minerals such as oil, gas and other hydrocarbons once extracted, and fixtures, a term which is not defined in the *Act*), documents of title, chattel paper, a security, an instrument, money and other intangible personal property.

38. The *PPSA* does not, however, apply to security interests taken under ss. 426 or 427 of the *Bank Act* (*PPSA*, *ibid.*, s. 5(k)) or to mortgages or sales registered pursuant to the *Canada Shipping Act* (*PPSA*, *ibid.*, s. 5(j)).

39. *Oceans Act*, *supra* note 8, s. 17(1).

40. *Ibid.*, s. 20(1).

41. *Ibid.*, s. 2.

Under s. 21(1) the laws of a province will apply in any area of “the sea” above the continental shelf that is not within any province *and* is prescribed by regulation. Subsection 26(1) of the *Oceans Act* provides authority for the federal government to make regulations prescribing that federal laws or provincial laws are applicable in or above the continental shelf of Canada. Notably, as of the date of this article (August 2001), no regulations have been made pursuant to the *Oceans Act* making any laws of the Province of Nova Scotia relating to security interests in real or personal property applicable to any part of the offshore area. This remains a significant gap in the current legislative framework.

5. *Bank Act*

Section 426 of the *Bank Act* allows banks to make loans on the security of:

- (i) hydrocarbons in the ground or “in place or in storage”;
- (ii) rights, licences or permits of any person to obtain and remove hydrocarbons;
- (iii) the estate or interest of any person in or to hydrocarbons, permits, licences or lands; and
- (iv) equipment and casing used to extract, produce or store hydrocarbons.⁴²

This provision allows a bank to take security on licences of the type issued pursuant to the *Nova Scotia Accord Acts* (*i.e.* exploration and production licences and SDLs). Subsection 104(1)(j) of the *Nova Scotia Accord Act* (Nova Scotia) defines “security interest” as including a security interest given pursuant to “Section 177” (now s. 426) of the *Bank Act*.⁴³ To the extent that it creates a charge on an exploration licence, significant discovery licence or production licence, security under s. 426 must be registered with the CNSOPB under the *Nova Scotia Accord Acts* in order to preserve the priority of the security.⁴⁴

In addition to licences, security can be taken under s. 426 over production and equipment and casing. On a strict reading of the *Nova Scotia Accord Acts*, any security taken under s. 426 falls within the definition of a “security interest.”⁴⁵ As such, all s. 426 security is subject to the registration requirements of the *Nova Scotia Accord Acts*.

42. *Supra* note 1, s. 426(1).

43. *Supra* note 2, s. 104(1)(j). The corresponding provision in the *Nova Scotia Accord Act* (Canada) is s. 105(1) which, parenthetically, includes the correct reference to s. 426 of the *Bank Act*, as per the amendment to it by the *Bank Act*, *supra* note 1, s. 586.

44. See the *Nova Scotia Accord Act* (Nova Scotia), *ibid.*, s. 114, and the *Nova Scotia Accord Act* (Canada), *supra* note 3, s. 115, which provide that competing security interests in licences have priority based on the first to be registered, not the first to be acquired.

45. See the *Nova Scotia Accord Act* (Nova Scotia), *ibid.*, s. 104(1)(j), and the *Nova Scotia Accord Act* (Canada), *ibid.*, s. 105(1).

There are limitations on the effectiveness of security taken under s. 426 of the *Bank Act*.⁴⁶ For instance, security can be taken under the *Bank Act* only by banks. Also, the rights of a bank on realization are limited under the *Bank Act*. A bank's rights of sale on realization may be exercised only by public auction.⁴⁷ The most significant limitation, however, relates to priorities. Under the *Bank Act*, priority is afforded to security taken by a bank under s. 426 only in respect of "rights subsequently acquired" in the collateral.⁴⁸ This means that it is possible that a prior unregistered security interest could have priority over security taken under s. 426.⁴⁹ The priority rules under the *Nova Scotia Accord Acts* are different.

The *Nova Scotia Accord Acts* contain a first-to-register priorities rule.⁵⁰ So a question arises as to whether the priority rules under the *Nova Scotia Accord Acts* or those under the *Bank Act* will apply with respect to s. 426 security registered at the CNSOPB Registry under the *Nova Scotia Accord Acts*. The priorities rule under the *Nova Scotia Accord Acts* is contained in s. 115 of the *Nova Scotia Accord Act* (Canada):⁵¹

115. (1) Subject to subsections (2) and (5), any particular right, in relation to an interest or a share therein, in respect of which an instrument has been registered under this Division at any time has priority over and is valid against any other right, in relation to that interest or share,

(a) in respect of which an instrument may be registered under this Division,

(i) where the instrument was not so registered, or

(ii) where the instrument was so registered after that time whether that other right was acquired before or after that particular right; or

(b) in respect of which an instrument may not be registered under this Division, acquired after that time.

46. See Wood, *supra* note 1 at 71-75, which discusses limitations on s. 426 *Bank Act* security.

47. Unless the debtor has otherwise agreed. See *Bank Act*, *supra* note 1, s. 426(6).

48. See s. 426(7) of the *Bank Act*, *ibid*. In addition to priority over subsequently acquired interests in the collateral, security under s. 426 has priority over mechanics' liens and claims of unpaid vendors unless the bank took its security with knowledge of those types of liens.

49. Wood, *supra* note 1 at 67, n. 2, and at 76.

50. *Nova Scotia Accord Act* (Nova Scotia), *supra* note 2, s. 114, and *Nova Scotia Accord Act* (Canada), *supra* note 3, s. 115. The general rule as to priorities is subject to certain transitional rules, the priority of operators' liens and, with respect to instruments that cannot be registered under the *Nova Scotia Accord Acts*, a registered security interest has priority only with respect to subsequently acquired interests.

51. See s. 104(1) of the *Nova Scotia Accord Act* (Nova Scotia), *ibid*.

It is noteworthy that the priorities rule in s. 115 only applies “in relation to an interest or share therein.” An interest means an exploration, production or significant discovery licence.⁵² As regards security interests in licences, the priorities rule in s. 115 should prevail over the priorities rule in the *Bank Act*, since the *Nova Scotia Accord Acts* are expressly stated to prevail over other federal and provincial legislation.⁵³ The priorities rules in ss. 114 and 115 of the *Nova Scotia Accord Acts* do not apply to security taken in relation to production or equipment and casing. Consequently, the priority of a s. 426 security on those types of assets should be determined according to the *Bank Act* and the security legislation pursuant to which the competing security interest has been taken.⁵⁴

6. *Canada Shipping Act*

The *Canada Shipping Act* may be applicable to certain of the assets of an offshore oil and gas project. A Canadian-registered supply or service vessel is an obvious example (although such vessels are more likely to be chartered rather than owned by the project owners). There are, however, other assets used in an offshore project to which the *Canada Shipping Act* will apply. For instance, a self-propelled semi-submersible oil rig, a floating crane and possibly even a jack-up may all fall within the scope of the definition of a “ship” under the *Canada Shipping Act*. This is all discussed in more detail below. For the purposes of a general overview, suffice it to say that a lender taking security on the assets of an offshore oil and gas project will want to consider the nature of the drilling and production units which are to be utilized in the project and owned by the project consortium and make an assessment as to whether any of it can be made subject to a mortgage under the *Canada Shipping Act*.

A Canadian-owned “ship” must be registered in Canada unless the vessel is registered in another country or is less than fifteen tons.⁵⁵ Section 37 provides that the owner of a “registered ship” or a share in one, or the owner of a ship recorded as being built in Canada, may mortgage the ship, or the owner’s share, as security. Section 39 provides that such

52. *Nova Scotia Accord Act* (Canada), *supra* note 3, ss. 2, 49; and *Nova Scotia Accord Act* (Nova Scotia), *ibid.*, s. 54(g).

53. *Nova Scotia Accord Act* (Canada), *ibid.*, s. 4; and *Nova Scotia Accord Act* (Nova Scotia), *ibid.*, s. 4.

54. An examination of priorities between the *Bank Act* and the *PPSA* is beyond the scope of this article. For a discussion of some of the priorities issues that may arise between federal and provincial security interests, see Wood, *supra* note 1.

55. *Canada Shipping Act*, *supra* note 1, s. 16(1). A ship is required to be registered only if it is owned solely by qualified persons - namely citizens or residents of Canada or corporations incorporated in Canada or a province.

mortgages have priority based on the date and time of registration. Priority is not based on the date of execution.

For registration purposes, the property in a ship is divided into sixty-four shares.⁵⁶ If the vessel has one owner, then the sole owner holds all sixty-four shares. If the various shares are owned by different owners, then each co-owner of a share holds an undivided interest in the ship in severalty. Each owner of a share can independently sell or mortgage the share or shares held and registered in his name. An individual share may be "jointly" owned. In that case, the share is held jointly with unity of title and no distinction of interest. The share or shares held jointly cannot be sold or mortgaged in severalty, but only with all joint owners joining the conveyance.

Under s. 41(1) of the *Canada Shipping Act*, the mortgagee of a ship, or a share in one, is conferred with the absolute power to sell the ship or the share, but in the case of multiple mortgages a subsequent mortgagee can only sell the ship or mortgaged share pursuant to a court order or with the consent of every prior mortgagee.⁵⁷

II. *Project Assets*

Having considered generally the underlying legislative framework, it is convenient to consider now the types of assets that would typically be available as collateral in connection with an offshore oil or gas project financing. For that purpose the principal assets can conveniently be considered in the following categories: (i) project agreements, (ii) exploration and production licences, (iii) permanent offshore marine installations, (iv) movable drilling and production units, ships and vessels, (v) petroleum produced, (vi) land-based processing facilities, and (vii) sales and other revenue producing contracts and transportation agreements.

III. *The Project Agreements*

1. *Overview of Project Agreements*

Because producing oil and gas offshore is a capital-intensive, high-risk undertaking, multiple-party joint ventures are a common feature of such projects. The management and operation structure of the joint venture will be set out in a series of project agreements between the co-owners. The agreements may include construction and operation agreements,

56. See W. Porges & M. Thomas, *British Shipping Laws: The Merchant Shipping Acts*, vol. 11 (London: Stevens & sons, 1963) at 8.

57. *Supra* note 1, s. 41(2). The ship mortgage provisions contained in Bill C-35, *supra* note 9, (the *Canada Shipping Act, 2000*) as introduced for first reading are substantially the same.

joint operating agreements, management agreements and processing facilities agreements. The project agreements will define the respective rights and obligations of the co-owners *inter se*. The terms and conditions of the project agreements will be of obvious interest to a co-owner's lender who may have to "step into the shoes" of the co-owner in the event of a loan default.⁵⁸

The project agreements will appoint an operator, usually the majority interest holder or a special purpose operating company. A management committee will usually be formed. The agreements will enumerate the powers of the management committee, which may include authority to make decisions on production rates and schedules, capital and operating budgets, contractual arrangements with third parties, and facilities modifications.

The project agreements may impose restrictions on the use of the project facilities, give priority of access to production from the joint venture fields and may specify how the co-owners will share revenues from the use of the project facilities by third parties. The project agreements will typically contain the obligations of the co-owners to contribute capital and share operating costs. Funding procedures may be established under the agreements. The agreements may provide for the rights and remedies of the co-owners in the event of a funding default by one of the owners. The agreements may specify the circumstances under which the project can be suspended or abandoned.

For reasons of convenience and operational efficiency, the project agreements may provide that legal title to the project assets will be held by the operator in trust, the co-owners retaining beneficial undivided interests equivalent to their working interest shares in the project. The project agreements may contain restrictions on the rights of the owners to transfer their interests in the project and may provide for rights of first refusal to the other co-owners. For operational reasons, the project agreements may feature provisions imposing a minimum percentage interest share that any co-owner is required to maintain in the project.⁵⁹ Transfers of project interests may further be restricted by requirements that transferees meet certain financial requirements so that the co-owners have some assurance that any transferee of an interest in the project will be capable of meeting its financial obligations to contribute to capital and

58. It is beyond the scope of the article to discuss in depth the terms and conditions of project agreements which will, in any event, vary to a greater or lesser extent from project to project.

59. The rationale for imposing a condition in the project agreements requiring that each owner, from time to time, have a minimum percentage interest in the project is that it avoids a situation in which there are an unmanageable number of small interest holders thereby impeding the ability of the owners collectively to make decisions.

operating costs. The project agreements may also provide for cross security on the project assets to be given amongst the co-owners as security for the funding contribution commitments of the co-owners.

The structure of the joint venture and the contractual rights and obligations of the co-owners *inter se* under the project agreements will be of obvious interest to a lender in the context of financing a co-owner's participation in an offshore oil and gas development. Lenders will want to understand the joint venture as structured under the project agreements and in most cases will likely require an assignment from the borrowing co-owner of its interest under the project agreements. Without an assignment of the project agreements and the corresponding right to "step into the shoes" of the co-owner and produce petroleum in conjunction with the other owners under a structured arrangement, the true value of the lender's other security in the project may not be realizable.

In the context of analysing the project agreements for the specific purpose of assessing issues respecting the securing of a co-owner's interest in the project assets, four questions in particular should be considered. First, are the co-owners prohibited, by a negative pledge or assignment covenant or other transfer restriction, from assigning contractual rights under the project agreements or interests in the project assets? Second, how is title held in the project assets and in particular, does the operator hold title to any assets in trust? Third, are there restrictions on the ability of the lender, in the case of default, to assume the borrower/co-owner's contractual rights and obligations under the project agreements? Finally, are there restrictions on the rights of the lender to reassign to a third party the contractual rights under the project agreements in the course of a realization of security?

2. *Security on Project Agreements*

The lender's security package should include a requirement for a specific assignment of the borrower's rights under the project agreements. In order for a lender to obtain an effective assignment of the borrower's rights under the agreements, the consent of the other project co-owners will more likely than not be required. It therefore seems unlikely that a situation would arise in which there are competing security assignments in the project agreements. Nevertheless, this type of assignment would fall within the definition of a "security interest" under the Nova Scotia *PPSA*. The *PPSA* includes a broad definition of a "security interest." It includes "an interest in personal property that secures payment or performance of an obligation."⁶⁰ Personal property, for the purposes of

60. *PPSA*, *supra* note 7, s. 2(ar).

the *PPSA*, includes intangibles.⁶¹ The definition of “intangibles” under the *Act* is not an exhaustive one, but an exclusionary one. “Intangibles” is defined simply as personal property other than goods, a document of title, chattel paper, a security, an instrument or money.⁶² Contractual rights are intangibles.⁶³

By virtue of s. 8 of the *PPSA*, the validity and perfection of security interests in intangibles is governed by the law of the jurisdiction in which “the debtor is located” at the time “when the security interest attaches.”⁶⁴ For that purpose, s. 8(1) provides that a debtor is “located” at the place of business of the debtor or at the debtor’s chief executive office if it has more than one place of business.⁶⁵ Consequently, it would be necessary to consider registering in Nova Scotia a specific assignment of the borrower’s rights under a project agreement only if the borrower’s only place of business or its chief executive office is located in Nova Scotia. If the borrower’s chief executive office is located in another province, the *Personal Property Security Act* of that province will be applicable and most provinces now have legislation which is, more or less, uniform.

61. *Ibid.*, s. 2(ad).

62. *Ibid.*, s. 2(w).

63. The definitions “intangible” and “personal property” in Nova Scotia’s *PPSA* are circular. “Personal property” is defined as meaning intangibles and other personal property like goods. “Intangibles” is defined as meaning “personal property” other than goods, chattel paper, etc. There appear to be no cases in Nova Scotia specifically holding that contractual rights are intangibles. In *Re Rektor* (1983), 3 P.P.S.A.C. 32 at 38 (Ont. S.C.) it was said by Smith J. that “a contract right can be said to be an intangible.” That case involved an issue as to whether an annuity contract was an intangible or an instrument (the latter of which is excluded from the statutory definition of “intangibles”). A contractual right is in the nature of a chose in action. (See G.H.L. Fridman, *The Law of Contract in Canada*, 4th ed. (Scarborough: Carswell, 1999) at 709.) Choses in action are “rights of property” which are distinguished from other property rights by virtue of the fact that a chose in action can only be enforced by legal action not taking possession. (See *Torkington v. Magee*, [1902] 2 K.B. 427 at 430; *DiGuilo v. Boland* (1958), 13 D.L.R. (2d) 510 at 513 (Ont. C.A.) and *Re A.G. for Ontario and Royal Bank of Canada*, [1970] 2 O.R. 467 at 472 (Ont. C.A.)). An assignment, by way of security, of contractual rights under project agreements is not excluded from the scope of the *PPSA* under s. 5(d), which excludes from the *Act* “a transfer of an unearned right to payment under a contract to a transferee who is to perform the transferor’s obligations under the contract”. (*PPSA, ibid.*, s. 5(d).)

64. *PPSA, ibid.*, s. 8(2). Under the *PPSA* a security interest attaches when value is given, the debtor has rights in the collateral and the secured party has possession of the collateral or a security agreement has been signed by the debtor. (*Ibid.*, s. 13.)

65. *Ibid.*, s. 8(1). Also see *Gimli Auto Ltd. v. Canada Campers Inc.* (1998), 13 P.P.S.A.C. (2d) 378 (Alta. C.A.); and *Ens Toyota Ltd. v. Megill Stephenson Co.* (1989), 9 P.P.S.A.C. 169 (Sask. Q.B.). Nova Scotia’s *PPSA* is modelled on the Alberta *Personal Property Security Act*, S.A. 1988, c. P-4.05, and the two statutes are almost identical.

IV. *Exploration and Production Licences*

The right to drill for and recover hydrocarbons in the offshore area is conferred by a licence granted under the *Nova Scotia Accord Acts*. Depending on the stage of the development, the project owners will hold either an exploration licence, a significant discovery licence or a production licence.

An assignment of the borrower's rights under such a licence will constitute a fundamental aspect of a lender's security for an offshore oil and gas project. The registration of security interests in all three types of licences is governed by the *Nova Scotia Accord Acts*. Failure to register a security interest does not render the security void *ab initio* or as against any particular class of creditors or otherwise. But a transfer of a licence is not "effective" as against the Crown until the transfer is registered.⁶⁶ Moreover, the general rule of priorities is that a registered security interest will have priority over an unregistered or a subsequently registered security interest.⁶⁷

The *Nova Scotia Accord Acts* permit only interests (*i.e.* licences) and "instruments" to be registered under the public registry system. "Instrument" includes a security notice,⁶⁸ which means a notice of a "security interest".⁶⁹ "Security interest" is defined in s. 104(1)(j) of the *Nova Scotia Accord Act* (Nova Scotia) as follows:

"security interest" means any charge on or right in relation to an interest or a share in an interest that secures

- (i) the payment of an indebtedness arising from an existing or future loan or advance of money,
- (ii) a bond, debenture or other security of a corporation, or
- (iii) the performance of the obligations of a guarantor under a guarantee given in respect of all or any part of an indebtedness referred to in subclause (i) or all or any part of a bond, debenture or other security of a corporation, and includes a security given pursuant to Section 177 of the Bank Act (Canada), but does not include an operator's lien;⁷⁰

66. *Nova Scotia Accord Act* (Nova Scotia), *supra* note 2, s. 117. The corresponding section in the *Nova Scotia Accord Act* (Canada), *supra* note 3, is s. 118.

67. *Nova Scotia Accord Act* (Nova Scotia), *ibid.*, s. 114. The corresponding section in the *Nova Scotia Accord Act* (Canada), *ibid.*, is s. 115.

68. *Nova Scotia Accord Act* (Nova Scotia), *ibid.*, s. 104 (1) (e); and *Nova Scotia Accord Act* (Canada), *ibid.*, s. 105(1).

69. *Nova Scotia Accord Act* (Nova Scotia), *ibid.*, s. 104(1)(k); and *Nova Scotia Accord Act* (Canada), *ibid.*, s. 105(1).

70. *Ibid.*, s. 104(1)(j). Also see *Nova Scotia Accord Act* (Canada), *ibid.*, s. 105(1).

It is noteworthy that the definition of “security interest” specifically includes a security interest under s. 177 (now s. 426) of the *Bank Act*. Consequently, to be effective, a security interest taken under s. 426 is required to be registered at the CNSOPB Registry under the *Nova Scotia Accord Acts*. The priority rules established under ss. 114 and 115 of the *Nova Scotia Accord Acts* with respect to security interests registered at the CNSOPB Registry with regard to licences should have precedence over the priority rules established by the *Bank Act* because the *Nova Scotia Accord Acts* are stated to prevail over other federal and provincial legislation.

There are certain requirements that must be satisfied under s. 110 before a security notice can be registered under the *Nova Scotia Accord Act* (Nova Scotia).⁷¹ The security notice must specify the nature of the security interest claimed, the person from whom the interest was acquired, and the documents giving rise to the interest and any other information prescribed by regulation. There are no applicable federal or provincial regulations as of the date of writing (August 2001).

It is important to bear in mind that a production licence, which among other things confers title to petroleum produced in the area covered by the licence, is required to be issued to only one producer.⁷² The *Acts* make it mandatory that the Board issue a production licence to one interest owner in respect of any one commercial discovery area, but the Board *may*, subject to the Board and the interest holders reaching an agreement, issue a production licence to two or more interest owners. In the case of a joint venture development, the production licence would typically be issued to the project’s operator. Although the production licence may be issued to the operator, the joint venture’s project agreements will likely provide that the licence is held by the operator in trust for the benefit of all of the project owners. The implications of this for the purposes of registering a security interest in a share of a production licence held (but not registered) in the name of the borrowing co-owner must be considered. Technically there should not be a problem registering a security notice against a share of a production licence even if the licence is held in the name of another company. Each production licence is assigned an identification number by the CNSOPB and any registered interests in the production licence can be identified by searching the interest abstract for the appropriate number of the production licence. It should not make any difference, for registration purposes, in whose name the production

71. *Nova Scotia Accord Act* (Nova Scotia), *ibid.*, s. 110.

72. *Nova Scotia Accord Act* (Nova Scotia), *ibid.*, s. 87(1)(a); and *Nova Scotia Accord Act* (Canada), *supra* note 3, s. 84(1)(a).

licence is registered so long as the security notice identifies the proper production licence number so that the interest can be recorded in the appropriate interest abstract.

If a security notice is registered against a production licence at the CNSOPB Registry then registration under the *Registry Act* or the *PPSA* is not necessary since the *Nova Scotia Accord Act* (Nova Scotia) prevails over other provincial legislation.⁷³ The priorities established under the *Nova Scotia Accord Acts* for instruments properly registered at the CNSOPB Registry with respect to licences could not be disturbed by the registration or lack of registration of a security interest under the *PPSA* since the *Nova Scotia Accord Acts* prevail over other provincial and federal legislation.

V. *Permanent Offshore Marine Installations*

The physical assets located offshore will include wells and a main production platform facility which may include some primary processing facilities such as dehydration facilities. Satellite platforms, gathering lines, storage facilities and sub-sea transportation pipelines may also form part of the offshore project assets. This category of assets is intended to include structures and facilities more or less permanently installed offshore, in distinction to movable drilling and production units, semi-submersibles, barges or floating cranes of a type that could constitute a ship under the *Canada Shipping Act*.

The types of facilities and structures under consideration here could potentially be the subject of two types of security: a security taken by a bank pursuant to section 426 of the *Bank Act*, or a fixed specific mortgage or a floating charge of the type that would ordinarily constitute a "security interest" within the meaning of the *PPSA*.

1. *Bank Act Security on Marine Installations*

Section 426(1)(d) of the *Bank Act* allows a bank to take security on "the equipment and casing used . . . in extracting, mining or producing . . . and storing . . . hydrocarbons".⁷⁴ The phrase "equipment and casing" is not defined in the *Bank Act* and there is little guidance to interpretation to be found in the case law. In a given case, it may be debatable whether a major production platform constructed offshore would constitute "equipment" within the meaning of s. 426(1)(d). Intuitively, such a platform would seem more accurately described as a "structure" rather than "equipment."

73. *Nova Scotia Accord Act* (Nova Scotia), *ibid.*, s. 4; and *Nova Scotia Accord Act* (Canada), *ibid.*, s. 4.

74. *Supra* note 1, s. 426(1)(d).

But “equipment” can have a broad dictionary definition — broad enough to include structures and everything else, other than land and buildings, used in a particular operation.⁷⁵ It could also be debatable whether a sub-sea pipeline used to *transport* hydrocarbons would be considered equipment or casing used to extract or produce hydrocarbons. Whether a pipeline is equipment within the scope of s. 426 would probably turn on whether the pipeline in question was in the nature of a gathering line used, for instance, to move raw gas to processing facilities as opposed to a transportation pipeline used to transport finished product. Unquestionably, other items of equipment used in the recovery and production of offshore oil and gas would be within the scope of the type of security permitted to be taken by banks under s. 426(1)(d). Ultimately, whether particular assets constitute “equipment” within that section will depend on the specific facts in a given circumstance. In cases of doubt, the bank should take a security interest and register a financing statement under the PPSA in addition to s. 426 security.⁷⁶

Subsection 426(7) provides that the rights and powers of the bank in respect of any property secured under s. 426 has priority over all rights subsequently acquired in the property and over any mechanics lien holder or a lien of an unpaid vendor of equipment or casing unless, in the latter case, the bank takes its security with knowledge of the lien.⁷⁷ The priority established by s. 426(7) is subject to s. 426(8). Subsection 426(8) provides that security under s. 426 does not have priority over any other registered security on the property unless, prior to the registration of the other security interest, the security taken by the bank under s. 426, or caveat in respect thereof, has been registered or filed either in the proper land registry or land titles office, or in the office in which rights, licences or permits to extract petroleum are recorded.⁷⁸

75. See *Webster's Third New International Dictionary of the English Language*, 1966 ed., which defines “equipment” *inter alia* as “all the fixed assets other than land and buildings of a business enterprise” and states that “equipment”, as a synonym for apparatus and machinery, can signify “all the things used in a given work or useful in affecting a given end.” *The Dictionary of Canadian Law* defines “equipment” as “[a]pparatus, device, mechanism, structure, machine, machinery, tool, device, contrivance or vehicle.” (D.A. Dukelow & B. Nuse, *The Dictionary of Canadian Law*, 2d ed. (Scarborough: Carswell, 1995) [emphasis added].)

76. Pending federal regulations prescribing that Nova Scotia’s PPSA applies to the offshore area, the effectiveness of registration of any security under the PPSA is subject to the caveat that Nova Scotia may lack constitutional authority to enact legislation applying to the offshore area.

77. *Bank Act*, *supra* note 1, s. 426(7).

78. *Ibid.*, s. 426(8).

The proper registry for security under s. 426 is the CNSOPB Registry established by the *Nova Scotia Accord Acts*. Section 104 of the *Nova Scotia Accord Act* (Nova Scotia)⁷⁹ defines “security interest” as including any security under s. 426 of the *Bank Act*. The definition does not limit the type of s. 426 security that is within the scope of the definition of “security interests” (which is to say the definition is broad enough to cover s. 426 security on any or all of licences, hydrocarbons or production equipment and casing). The *Nova Scotia Accord Acts* provide a system for registration at the CNSOPB Registry of licences for the exploration and production of hydrocarbons. For purposes of s. 426(8) of the *Bank Act*, the CNSOPB Registry is the “office in which are recorded the rights, licenses or permits”⁸⁰ to obtain and remove hydrocarbons in the offshore area. Accordingly, all security under s. 426, whether it charges licences or equipment and casing or production, should be recorded at the CNSOPB Registry. Since security interests registered at the CNSOPB Registry are recorded according to the assigned licence numbers, where equipment is being secured under s. 426, caution must be exercised to ensure that searches and filings take into account all licence numbers in respect of which the equipment, especially if it is movable, may be used.

The priority rules established by ss. 114 (Nova Scotia) and 115 (Canada) of the *Nova Scotia Accord Acts* only apply to security interests in licences. It would seem, therefore, that although security taken in respect of equipment or casing under s. 426 of the *Bank Act* should be registered under the *Nova Scotia Accord Acts* at the CNSOPB Registry, the priority of such security will depend on the provisions of the *Bank Act* and the security legislation applicable to any competing security interest.

2. *Registration of Security in Marine Installations pursuant to the Personal Property Security Act*

The *PPSA* applies to personal property which, by definition, includes “goods;”⁸¹ “goods” is defined to include both tangible personal property and fixtures.⁸² This would unquestionably include equipment and other tangible personal property used to produce oil or gas. Major marine installations, such as platforms or sub-sea pipelines, may not constitute tangible personal property, but it is hard to imagine that such assets would

79. *Supra* note 2, s. 104. Also see s. 105 of the *Nova Scotia Accord Act* (Canada), *supra* note 3.

80. *Bank Act*, *supra* note 1, s. 426(8).

81. *PPSA*, *supra* note 7, s. 2(ad).

82. *Ibid.*, s. 2(u).

not be regarded as fixtures, if not tangible personal property. Therefore, even large offshore installations would likely be within the ambit of the *PPSA*.⁸³

In order to perfect a security interest in goods, the secured party must either be in possession of the goods or, more commonly, a financing statement must be registered under s. 44 of the *PPSA*.⁸⁴ For registration purposes, the *Removal Permit Act* deems Halifax County to be the location of any goods physically “located in” the offshore area comprising the Nova Scotia lands.⁸⁵ This is significant because s. 6 of the *PPSA* provides that the validity and perfection of a security interest in goods is governed by the law of the jurisdiction where the collateral is situated when the security attaches (*i.e.*, when value is given, the debtor has rights in the collateral and either the goods are in the possession of the secured party, or, more typically, the debtor has executed a security agreement⁸⁶). If at the time of attachment, the goods are located offshore, the question arises as to what “jurisdiction” the goods are then situate in for the purposes of s. 6 of the *PPSA*. The *Removal Permit Act* deems goods located on Nova Scotia lands offshore to be located in the County of Halifax, an area clearly within the geographical boundaries of the province. On this analysis, the *PPSA* should govern issues relating to the validity and perfection of security interests in tangible personal property and fixtures located offshore. By way of caution however, if it were to be held that neither the offshore area nor the exploitation rights for offshore resources belong to Nova Scotia, then s. 18 of the *Removal Permit Act* would be inapplicable and the federal laws of Canada would apply in determining issues relating to the validity and perfection of security interests in tangible personal property and fixtures located offshore. The problem with this, of course, is that there is no legislated security registration regime in place under federal law except for the *Bank Act* and *Canada Shipping Act*, both of which are of limited scope and application.

The *PPSA* also contains provisions dealing with security interests in goods located in other jurisdictions at the time of attachment, fixtures and accessions. The implications of these provisions may have to be considered in a given financing transaction depending on the nature of the collateral being taken as security. For instance, during the construction phase of an offshore development, various components of the major

83. Subject to the caveat mentioned *supra* note 75.

84. See *PPSA*, *supra* note 7, ss. 20, 25, 26, 44.

85. *Supra* note 6, s. 18(4).

86. See *PPSA*, *supra* note 7, s. 13.

offshore facilities (platforms, sub-sea pipelines, *etc.*) may be procured from manufacturing or assembly plants that could be located almost anywhere in the world. Title to a particular component may pass to the project owners at the manufacturing or assembly plant at the time the component is fabricated. Alternatively, title may pass at the time of installation of the component in the offshore area.

Under the *PPSA*, a security interest is considered to have attached to the goods when the debtor obtains "rights" in the goods and has executed a security agreement covering the goods. If at the time the security interest attaches, the goods are located outside Nova Scotia (as would be the case where the owners take title at the plant to components fabricated in another province or country) and the secured creditor has a perfected security interest under the laws of the jurisdiction in which the goods are then located, the lender's security is deemed to continue to be perfected when the goods are brought into Nova Scotia (for example, for installation as part of an offshore facility). This is significant because the general priority rule regarding perfected security interests under the *PPSA* is that priority is determined by the order of occurrence of the perfection step.

The continuation of perfection of a security interest means essentially that the time of perfection dates back to the time of perfection in the other jurisdiction. In order, however, for the secured creditor to preserve the benefit of the continuing perfection rule in Nova Scotia, the creditor's security interest must be perfected in Nova Scotia by registration of a financing statement not later than sixty days after the goods are brought into the province or fifteen days after the secured party has knowledge the goods have been brought into the province, whichever is earlier.⁸⁷ A secured creditor who does not fit within these conditions can still perfect a security interest in goods brought into Nova Scotia from another jurisdiction by registering a financing statement, but in that case the secured party will not have the benefit of the continuing perfected security rule which, for priority purposes, dates back the time of perfection to the date the security was perfected in the jurisdiction in which the goods were fabricated. For that reason, a lender should consider obtaining and perfecting security in respect of major project components in the jurisdiction in which the components are being fabricated, if title will be passing to the project owners in that jurisdiction.

Difficult questions can arise in determining whether a particular facility or structure (such as a platform or pipeline) constitutes tangible personal property or a fixture which has lost its character as a chattel and

87. *Ibid.*, s. 6(3).

become part of the realty.⁸⁸ There are few cases that have considered whether particular oil and gas assets on land are “fixtures.”⁸⁹ There seem to be no reported cases, in Canada at least, that have considered whether major offshore oil and gas installations can be regarded as fixtures. The determination of whether something is a fixture must be assessed by reference to common law principles. Generally it depends on the extent to which the item has been annexed or affixed to the land. Ultimately the question turns on the particular facts in a given situation.⁹⁰ The *PPSA* applies to security interests in fixtures. The *Act* provides for specific rules to determine the priority of a security interest in the fixture as against the rights of a person acquiring title to the land to which the fixture has become attached.⁹¹ Fortunately perhaps, issues concerning these types of priority disputes (between a secured party with a perfected security interest in a fixture and the land owner) are more academic than real in the context of an offshore oil and gas project, because the land owner will always be the Crown.

Lenders will also want to consider the implications associated with the fact that major items of production equipment may be installed or affixed to other items of equipment. Goods that are installed in or affixed to other goods are “accessions” for the purposes of the *PPSA*. Section 39 of the *Act* prescribes certain rules for determining the priority of the secured parties and purchasers for value who may have rights in the accession only or in the whole of the goods including the accession.

VI. *Movable Drilling and Production Units, Ships And Vessels*

1. *Mortgages Pursuant to Canada Shipping Act*

Depending on what stage the offshore project has reached at the time of the financing and the nature of the assets owned by the project consortium which are to be utilized in the development and secured as part of the financing, the mortgage provisions of the *Canada Shipping Act* may have

88. The general principles relating to whether an object has become a fixture are set out in *Stack v. T. Eaton Co.* (1902), 4 O.L.R. 335 at 338 (Div. Ct.).

89. In *Burnside v. Marcus* (1867), 17 U.C.C.P. 430 (C.A.), it was held that an engine used for drilling for oil was not a fixture. In *Lahey v. Queenston Quarry Co.* (1916), 11 O.W.N. 18 (H.C.), it was held that a derrick erected in a quarry was a chattel. But in the United States, well casings, derricks, engines and plant and equipment used for the production of oil have been held to be fixtures (see W.L. Summers, *The Law of Oil and Gas*, vol. 3 (Kansas City, Mo: Vernon Law Book Co., 1938) at 453; and *McGreevy v. Constitution Life Insurance*, 47 Cal. Rptr. 711 (C.A. 1965)).

90. See *Stack v. T. Eaton Co.*, *supra* note 88.

91. *PPSA*, *supra* note 7, s. 37.

to be considered.⁹² That statute applies to mortgages of recorded “ships” under construction and registered “ships” when built. The first important point to bear in mind is that the term “ship,” when used in this context, could have a very broad scope. It obviously extends to ships as commonly understood, but it may also extend to other, less obvious, ocean-going equipment such as self-propelled or movable semi-submersibles, cranes and barges and arguably, jack-up rigs.

The starting point in the analysis is the definition of “ship” in s. 2 of the *Canada Shipping Act*. It is not an exhaustive one. Section 2 provides that “ship” is deemed to include (and is therefore not limited to) the following:

- (a) any description of vessel used in navigation and not propelled by oars, and
- (b) for the purpose of Part I and sections 574 to 581, any description of lighter, barge or like vessel used in navigation in Canada however propelled.⁹³

The *Federal Court Act* adopts the definition of “ship” from s. 673 of the *Canada Shipping Act*⁹⁴ and there have been a number of cases which have considered whether certain types of objects used on the water constitute “ships” within the definition of that term contained in the *Federal Court Act*.⁹⁵

92. On June 8, 2000 Bill C-35, *supra* note 9 (the *Canada Shipping Act, 2000*), received first reading in the House of Commons. Bill C-35 died on the Order Table in October 2000. It has been replaced by Bill C-14 (*Canada Shipping Act, 2001*). The *Canada Shipping Act, 2001* would represent a substantial overhaul of the existing statute. As of the date of this article (August 2001), the *Canada Shipping Act, 2001* is not in force. It should also be noted that many of the assets to which the *Canada Shipping Act* (or the *Canada Shipping Act, 2001*) would potentially apply (semi-submersible oil rigs, floating cranes, etc.) may be owned by third parties and chartered or leased to the owners and, as such, would not be considered for collateral as part of an offshore oil and gas project financing.

93. *Canada Shipping Act, supra* note 1, s. 2.

94. See the *Federal Court Act*, R.S.C. 1985, c. F-7, s. 2(1), as am. The definition of “ship” in s. 673 of the *Canada Shipping Act* is, if anything, more restrictive than the definition in s. 2 of the *Canada Shipping Act*. Section 673 defines “ship” as including “any description of vessel or craft designed, used or capable of being used solely or partly for navigation, without regard to method or lack of propulsion.” *Supra* note 1, s. 673, as am. by S.C. 1998, c. 6, s. 5. The *Canada Shipping Act, 2000* if enacted pursuant to Bill C-35, would eliminate the definition of “ship” in s. 2 and would replace it with a definition of “vessel” as follows:

“vessel” means a boat, ship or craft designed, used or capable of being used solely or partly for navigation in, on, through or immediately above water, without regard to method or lack of propulsion, and includes such a vessel that is under construction. It does not include a floating object of a prescribed class.

(*Canada Shipping Act, 2000, supra* note 9, s. 2.)

Since the definition of “vessel” would include “ship,” the cases that have considered what constitutes a “ship” at common law should continue to be applicable to the *Canada Shipping Act, 2000*.

95. See W.W. Spicer, *Canadian Maritime Law and the Offshore: A Primer* (Calgary: The Canadian Institute of Resources Law, 1984).

In the Federal Court of Appeal decision in *R. v. St. John Shipbuilding & Dry Dock Co.*,⁹⁶ the court was asked whether the Federal Court of Canada had the jurisdiction under Canadian maritime law to try a case respecting a floating crane. It was argued that the court lacked jurisdiction because the floating crane was not a ship or vessel. The court rejected the argument:

Applying the foregoing law to the floating crane described earlier herein, I am of the opinion that the “Glenbuckie” [the crane] was a ship within the meaning of the definition of that word in the *Federal Court Act*. Just as was the case of the definition of ship in *The “Mac”*, *supra*, the definition of ship in the *Federal Court Act* is not exclusive but inclusive. It, thus, enlarges the term. She was a barge built for use on water. She was capable of being moved from place to place and was so moved from time to time, as it was in this case to unload the cargo from the “Eminent Scol” She was capable of carrying cargo and had, in fact, done so. She was certainly capable of carrying people and obviously had to do so to enable the crew to carry out their duties. While it appears that she was not capable of navigation herself and was not self-propelled, those facts do not detract from the fact that she was built to do something on water, requiring movement from place to place. Therefore, in my opinion, the “Glenbuckie” was a ship.⁹⁷

In the course of his decision in *Re Seafarers’ International Union of Canada and Crosbie Offshore Services*,⁹⁸ Thurlow C.J. of the Federal Court of Appeal made the following comments respecting the nature of offshore oil rigs, albeit as *dicta*:

The rigs are also ships. They have means of self-propulsion but for one reason or another may be towed to a drill site. When located, the rig can be partly submerged and operate while resting on the bottom in water not more than 120 feet deep. In deeper water and in particular in those here involved the rig is partially submerged but floats. It is maintained in its position by anchors, which, as already indicated, are placed in position by the service vessels.⁹⁹

An important factor in determining whether an object is a ship is whether it is capable of being moved and is moved from time to time as opposed to being stationary (in some sense permanently) in its use or operation. A floating barge, even if incapable of self-propulsion, is a ship if it is capable of being towed and moved from place to place.¹⁰⁰ An oil drilling barge capable of being moved from place to place was held to be

96. (1981), 126 D.L.R. (3d) 353 (F.C.A.).

97. *Ibid.* at 362.

98. (1982), 135 D.L.R. (3d) 485 (F.C.A.).

99. *Ibid.* at 495.

100. See *The Mac* (1882), 7 P.D. 126 (C.A.); *The Mudlark*, [1911] P. 116 (Adm. Ct.); *Cook v. Dredging & Construction Co.*, [1958] 1 Lloyd’s L.R. 334; and *The Lighter No. 3* (1902), 18 T.L.R. 322 (Adm. Ct.).

a ship in the United States in *A-1 Industries v. Barge Rig #2*.¹⁰¹ A mobile drilling platform with retractable legs and a submersible drilling barge which rested on the sea bottom while drilling have been held to be ships in the United States.¹⁰² However, objects which are stationary and are, more or less, permanently fixed in one location have been held not to be ships. For instance, in *The Craighall*, it was held that a landing stage on the Mersey River was not a vessel according to Fletcher Moulton L.J.:

To my mind it is clear beyond all question that this landing-stage is not a vessel. It is a huge floating structure intended to be a permanent structure and stationary, except in one respect, namely, that, for the convenience of passengers, it has the power of rising and falling with the water. Otherwise it is absolutely fixed. It has none of the characteristics of a vessel¹⁰³

In *The Upcerne*,¹⁰⁴ the court held that a floating gas buoy was not a ship.

I therefore see no distinction in principle between an object of this kind, which, though floating, is fixed to the bottom of the sea in order that it may always be approximately in the same spot upon the surface of the water, and a pierhead, which is a more permanently fixed object.¹⁰⁵

A fixed production platform constructed offshore and more or less fixed in one location would likely not be considered a ship. In *Loffland Bros. v. Roberts*¹⁰⁶ it was held that a fixed offshore platform was not a vessel. The important distinction is whether the object is more or less permanently fixed (in which case it is probably not a ship) or whether it is capable of being moved and is intended to do work on water. In *Polpen Shipping v. Commercial Union Assurance* Atkinson J. stated,

I do not want to attempt a definition, but if I had to define "ship or vessel" I should say that it was any hollow structure intended to be used in navigation, i.e., intended to do its real work on the seas or other waters, and capable of free and ordered movement thereon from one place to another.¹⁰⁷

In terms of making an assessment of whether a particular object used on the water is a "ship," a number of relevant factors can be gleaned from the cases. A significant factor is whether the object was built and designed to do something on water (such as carrying cargo, equipment or people). Whether the object is capable of being moved from place to place and whether it was in fact moved from time to time are also

101. [1979] 2 A.M.C. 1486 (E.D. La. 1979).

102. See *Offshore Co. v. Robinson*, 2 A.M.C. 2049 (5th Cir. 1959); and *Producers Drilling Co. v. Gray*, 1 A.M.C. 1260 (5th Cir. 1966).

103. [1910] P. 207 at 212 (C.A.).

104. [1912] P. 160 (Adm. Ct.).

105. *Ibid.* at 166.

106. 386 F.2d 540 (5th Cir. 1967).

107. (1942), [1943] K.B. 161 at 167.

important factors. The fact that the object is incapable of self-navigation or is not self-propelled is not determinative. An object that can be towed from one place to another may still constitute a ship. The fact that the object may be partially submerged or resting on the seabed does not mean necessarily that it is not a ship. At the end of the day, the determination of whether a particular object is a ship is a question of fact that will depend on all of the circumstances. A production platform installed offshore and fixed (more or less permanently) would not constitute a ship, however, it is evident from the cases that certain types of rigs, semi-submersibles, floating cranes and barges may be “ships.”

By way of cautionary note, there are complications with registering a mortgage under the *Canada Shipping Act* against a “ship” where registered title is held in trust. Section 37 permits the “owner” of a ship or a share in a ship to give a mortgage on the ship (or the share of it) as security. “Owner” is defined in s. 2 as meaning the “registered owner only.” Therefore, a beneficial (unregistered) owner cannot grant a mortgage registerable under the *Canada Shipping Act*. The mortgage can only be given by the registered owner. So if the ship is registered in the project operator’s name (pursuant to trust provisions under the project agreements), the operator as registered owner will need to execute the mortgage.

Some potentially difficult priority issues may arise with respect to mortgages and other security interests in “ships.” It is beyond the scope of this article to endeavour to analyze those issues in an in-depth manner. It is, however, worth noting that there are a number of factors that could complicate a priorities dispute involving mortgages and other security interests in “ships.” The first is that maritime law may apply both to the procedural aspects of enforcing a security interest in a ship and the determination of priorities of various claimants.¹⁰⁸ Under maritime law certain possessory and maritime liens may have priority over a mortgage registered against a ship under the *Canada Shipping Act*.¹⁰⁹ Second, the *Canada Shipping Act* only permits mortgages to be filed in respect of ships that are registered under it.¹¹⁰ A number of potential complications could flow from this. One potential complication is that an unregistered ship which is made subject to a security interest outside the *Canada Shipping Act* could subsequently be registered under that statute and be made subject to a statutory mortgage filed in accordance with the *Act*. The subsequently registered statutory mortgage would likely have priority in

108. See Wood, *supra* note 1 at 91-94.

109. *Ibid.* at 93.

110. *Canada Shipping Act*, *supra* note 1, s. 37(1).

those circumstances. The accepted view seems to be that the first-to-register priority rule in the *Canada Shipping Act* applies to priorities as between two registered statutory mortgages as well as to priorities between a registered statutory mortgage and a prior or subsequent unregistered security interest.¹¹¹ It is noteworthy in this regard that the priorities rule in the *Canada Shipping Act* applies “notwithstanding any express, implied or constructive notice.” So it should make no difference, in determining priorities, that the subsequent mortgagee with a registered statutory mortgage had actual notice of a prior mortgage or security interest that was not registered under the *Canada Shipping Act*. The potential problems are compounded by the fact that, although the *Canada Shipping Act* requires certain vessels to be registered, the *Act* permits the registration of other types of ships.¹¹² A situation could therefore arise in which the first secured party cannot take a statutory mortgage under the *Canada Shipping Act* on a particular vessel because it is not registered under the *Act*, only to find that the ship is subsequently registered and made subject to a statutory mortgage under the *Act*. Finally, it is important to bear in mind that security interests in ships could be taken and registered pursuant to security statutes other than the *Canada Shipping Act*. For instance, a semi-submersible rig may constitute “equipment” used to produce or recover hydrocarbons within the meaning of s. 426 of the *Bank Act* and be subject to a security under that statute. Under the *PPSA*, mortgages “registered” under the *Canada Shipping Act* are excluded from the *PPSA*, but a ship itself is not excluded. A ship is tangible personal property and a security interest could be taken under the *PPSA*. All of this means that there is potential for competing claims to arise under various federal and provincial legislation in respect of ships that are not subject to a registered mortgage under the *Canada Shipping Act*.

2. Registering Security Interests on Moveable Personal Property under the Personal Property Security Act

The *PPSA* does not apply to mortgages “registered” under the *Canada Shipping Act*.¹¹³ The *PPSA* may apply to security taken on project assets that are moveable tangible personal property (such as rigs, semi-submersibles, jack-ups, etc.), to the extent such security does not constitute a “registered” mortgage under the *Canada Shipping Act*. This does not mean that a lender is precluded from taking security under a *PPSA*-

111. See Wood, *supra* note 1 at 88; and *Royal Bank of Canada v. 273050 B.C. Ltd.* (1991), 86 D.L.R. (4th) 551 (B.C. S.C.).

112. *Canada Shipping Act, supra* note 1, s. 17. For instance a mortgage may be registered in respect of a Canadian owned “ship” that is under 15 tons and is not registered in a foreign country.

113. *PPSA, supra* note 7, s. 5(j).

type security agreement against a ship in addition to (or, subject to priorities considerations, even instead of) a mortgage in the prescribed form registered under the *Canada Shipping Act*. Ships are personal property and ships themselves are not excluded from the application of the *PPSA*. It is only “registered mortgages” under the *Canada Shipping Act* to which the *PPSA* does apply. A lender may want to consider registering a financing statement under the *PPSA* in respect of its security against a ship where it is not possible to register a mortgage under the *Canada Shipping Act*, for instance where title to the ship is registered in the name of another corporation acting in a trust capacity.

The perfection and priority rules under the *PPSA* apply to all “goods” (which includes tangible personal property like movable equipment, rigs and semi-submersibles, and fixtures) located in Nova Scotia when the security interest attaches.¹¹⁴ For security registration purposes, the *Removal Permit Act* deems all personal property located in the “Nova Scotia lands” offshore to be located in Halifax County — that is, within the geographical boundaries of the province of Nova Scotia. Essentially, the same registration and priority considerations apply to moveable personal property as arise with respect to personal property that has been installed or has become, more or less, permanently affixed in the offshore area.¹¹⁵ There is, however, at least one major deficiency in the current legislative framework governing moveable personal property. It is the lack of federal legislation making provincial laws applicable to personal property offshore. If Nova Scotia lacks legislative jurisdiction in the offshore on the basis that it does not own the resource exploitation rights offshore, then s. 18 of the *Removal Permit Act* has no application to property located in the offshore area, and issues relating to the validity and priority of security taken on assets at the time they are located offshore will fall to be determined by federal law. Aside from the *Bank Act* and the *Canada Shipping Act*, there is no federal legislation that provides for a system of registering security interests in personal property located offshore. This means that an unregistered security interest could conceivably have priority to a security interest registered under the *PPSA*.¹¹⁶

114. *Ibid.*, s. 6(1).

115. See the discussion in Part VII, Section 2 of this article.

116. Also, an unregistered security interest in goods outside Nova Scotia could have priority by virtue of the continuing perfection rule. A perfected security interest in goods located outside Nova Scotia will continue in Nova Scotia if a financing statement is filed within sixty days after the goods are brought into Nova Scotia or fifteen days after the secured party has knowledge of the goods having been brought into the province, whichever is earlier.

VII. Production

Security on the petroleum recovered could take the form of security under s. 426 of the *Bank Act* or a mortgage, assignment, floating charge or other form of security interest governed by the *PPSA*.

1. *Bank Act Security on Production*

The primary issue with respect to *Bank Act* s. 426 security against production relates to the registration requirements. Subsection 426(7) provides that the rights and powers of the bank in respect of any property secured under s. 426 has priority over all rights subsequently acquired in the property.¹¹⁷ The priority established by s. 426(7) is subject to s. 426(8). Subsection 426(8) provides that security under s. 426 does not have priority over any other registered security on the property unless, prior to the registration of the other security interest, the security taken by the bank under s. 426, or caveat in respect thereof, has been registered or filed:

- (i) in the proper land registry or land titles office; or
- (ii) in the office in which rights, licences or permits to extract petroleum are recorded.

Theoretically it may be possible to register a s. 426 security taken against a production licence at the Registry of Deeds office in Halifax on the assumption that the licence is in the nature of a *profit-à-prendre* which creates an interest in land.¹¹⁸ The argument would be that the *Removal Permit Act* authorizes security to be taken in an interest in real property and that by virtue of s. 18(4) of the *Removal Permit Act*, the proper county for the registration of such an interest is Halifax County. Whether such an argument is academically sound is debatable. The practical reality is that it is doubtful the *Removal Permit Act* is constitutionally valid to the extent that it purports to apply to the offshore area on the continental shelf. To avoid potential controversy as to the proper registry for s. 426 security over production, or equipment and casing, appropriate legislation should

117. Section 426 does not give priority over prior rights in the property existing when the security is taken under s. 426.

118. See *Berkheiser v. Berkheiser*, [1957] S.C.R. 387; *Atlantic Concrete v. LeVatte Construction Co.* (1975), 62 D.L.R. (3d) 663 (N.S. S.C. (A.D.)); *McColl-Frontenac Oil v. Hamilton* (1952), 5 W.W.R. (N.S.) 1 (Alta. S.C. (A.D.)); and *Garland v. Jones*, [1993] 7 W.W.R. 102 (Sask. Q.B.). The registry systems in some western provinces permit registration of caveats. Nova Scotia's registry system does not. It has been held in several cases that a "caveat" is not a registrable instrument under Nova Scotia's *Registry Act*, *supra* note 23. See *Lemorand Projects Ltd. v. Old Sack Holdings Ltd.* (1987), 80 N.S.R. (2d) 133 (S.C. (T.D.)); *Church v. Forbes* (1983), 60 N.S.R. (2d) 211 (S.C. (T.D.)); *Blades v. Atwood* (1990), 95 N.S.R. (2d) 348 (S.C. (T.D.)); and *Royal Bank v. Kesebi* (1997), 163 N.S.R. (2d) 321 (S.C.).

be adopted. The Nova Scotia land registry system is not designed to accommodate the registration of these types of interests. As matters now stand, security under s. 426 of the *Bank Act* (to the extent it charges assets of an offshore project) can and should be registered at the CNSOPB Registry pursuant to the *Nova Scotia Accord Acts*. However, it should be noted that the priority rules established under the *Nova Scotia Accord Acts* (essentially first registration has priority) do not apply to security registered under the *Acts* except in respect of licences. Therefore, the priority of s. 426 security on assets other than licences (e.g. production or equipment) would be governed by the *Bank Act* and the security legislation of the competing security interests.

2. Registration of Security Interests in Production pursuant to the Personal Property Security Act

The *PPSA* applies to security interests taken in hydrocarbons except for security taken under s. 426 of the *Bank Act*.¹¹⁹ The *PPSA* defines “goods” as including tangible personal property, but excludes “minerals until they are extracted.”¹²⁰ Subsection 2(z) defines “minerals” as including oil, gas and hydrocarbons.

Subsection 8(6) of the *PPSA* provides that the law of the jurisdiction in which the wellhead is located governs the validity and perfection of a security interest in oil, gas or other hydrocarbons or in an account resulting from the sale of hydrocarbons at the wellhead. The question is, what is the applicable “jurisdiction” if the wellhead is located in the area offshore Nova Scotia? It is by no means certain that Nova Scotia is the “jurisdiction” for that purpose. Subsection 18(4) of the *Removal Permit Act* states that for the purpose of registration of security, real and personal property located in Nova Scotia lands is deemed to be located in the County of Halifax. Assuming that this provision is constitutionally valid such that recovered hydrocarbons located in the offshore area are deemed to be located in Halifax County, it is still a matter of debate as to whether the law of Nova Scotia applies with respect to the validity and perfection of a security interest in the hydrocarbons given that s. 8(6) of the *PPSA* states that for that purpose the law of the jurisdiction *in which the wellhead is located* governs and not the laws of the jurisdiction where the hydrocarbons are located.

This issue is relevant primarily for determining whether or not a security interest in hydrocarbons located or stored offshore is required to be registered under the *PPSA* in order to be effective, and also for the purpose of assessing priorities. If the laws of Canada only apply to the

119. *PPSA*, *supra* note 7, s. 5(k).

120. *Ibid.*, s. 2(u).

offshore area, then no registration under the *PPSA* is required unless and until the oil or gas is brought onshore Nova Scotia. A prudent lender will, however, consider registering a financing statement for security taken on hydrocarbons offshore as soon as practical after the security agreement is taken in order to ensure that the security is perfected as soon as the hydrocarbons are brought onshore (or to ensure the security is perfected immediately if the offshore area is held to be within the province of Nova Scotia). There is, however, no assurance that registering a security under the *PPSA* against hydrocarbons will result in priority even if, at the time, there are no prior registrations under the *PPSA*. The reason is that it is conceivable that another creditor may already have taken security on the hydrocarbons which, although not registered under the *PPSA*, would nevertheless be valid under federal law. Assuming only federal law applies to the offshore area where the wellhead is located, then if the prior unregistered security interest is subsequently registered in Nova Scotia within sixty days after the hydrocarbons are brought into the province or within fifteen days after the secured party has knowledge that the hydrocarbons have been brought into the province, then by virtue of the continuing perfection rule under *PPSA* s. 6(3), the security interest will continue to be perfected and may have priority even though it is not the first to be registered under the *PPSA*. These potential difficulties could be avoided by federal and provincial legislation deeming all offshore wellheads to be located in Nova Scotia for the purposes of the *PPSA*. Under the *PPSA* the lender's rights in the collateral (for example the hydrocarbons) will continue in the collateral if it is "dealt with or otherwise gives rise to proceeds," unless the secured party has expressly or impliedly authorized the dealing.¹²¹ "Dealing" with the security in this context includes a sale. In most cases, the lender will have authorized, if not expressly then impliedly, the borrower to deal with its share of production by selling it. Ordinarily, therefore, the secured party's rights in hydrocarbons which have not or cannot be seized will be lost when title passes to the buyer. However, by virtue of s. 29(1)(b) of the *PPSA* the security interest taken originally by a lender in the hydrocarbons extends to the proceeds of sale. "Proceeds" is a defined term. In the context of a sale, it means "identifiable" or "traceable" personal property derived from the sale of the original collateral.¹²² The fact that the proceeds must be "identifiable" or "traceable" does not give rise to any particular problems if the lender is able to intercept the proceeds of sale before they are paid to the borrower and deposited to its account. If, however, the

121. *Ibid.*, s. 29(1).

122. *Ibid.*, s. 2(ag)(I).

proceeds of sale have been paid to the borrower, difficulties can arise in attempting to identify and trace the particular proceeds that are the subject of the lender's continuing security interest. The proceeds may have been deposited into the borrower's general operating account and been commingled with other revenue of the borrower. These problems may be avoided if the lender requires the borrower to deposit proceeds from sales to a segregated trust account, but that will not always be practical and the borrower may resist such a requirement.

There is another significant aspect of the continuing nature of a security interest in the proceeds from the sale of the original collateral. As a general rule, the priorities under the *PPSA* are determined based on the timing of perfection (usually registration) of a security interest. Under s. 29(3), the perfection of a security interest in proceeds is deemed to be continuous (which is to say it in effect dates back to the date of registration of a financing statement for the original collateral) if the financing statement for the original collateral contains a sufficient description of the "proceeds."

VIII. *Land-Based Processing Facilities*

The project may involve the construction and operation of land-based facilities for storing, processing or transporting the production from offshore. These facilities may include petroleum storage facilities, warehousing facilities, pipelines and, in the case of a natural gas project, a gas plant or other processing or fractionation facility. These facilities typically will consist of buildings, structures, plants and other major installations permanently affixed to land owned by the project consortium.

A lender could secure the interest of one or all of the project co-owners in such a facility by taking a real property mortgage. Assuming the project agreements permit the co-owners to mortgage their respective interests in the land-based facilities, there should be no particular issues in taking and registering mortgage security unless title to the land-based assets is held in the name of the operator or a special purpose operating company in trust for the co-owners. In that case, a number of potential issues arise.

First, if title is held in trust, then in order to create and register an effective mortgage on the land, it will be necessary for the party who is the registered title holder to execute the mortgage. If the operator is holding the assets in trust for the owners and the operator is the registered title holder, it will be necessary for the operator to execute the mortgage. Unless the operator is the borrowing co-owner, the operator's cooperation will need to be secured and the mortgage document will have to be

drafted taking into account that the mortgagor (as a bare trustee holding registered title) is not liable for the debt or on any of the covenants contained in the mortgage.

Second, a lender must exercise caution in taking a mortgage from a bare trustee in light of the “sealed contract rule.” There is a practice in Nova Scotia of executing under seal all deeds and mortgages that will be recorded at the Registry of Deeds. The implications of a trustee executing an instrument under seal and the so-called “sealed contract rule” were considered in a recent decision of the Supreme Court of Canada in *Friedmann Equity Developments v. Final Note Ltd.*¹²³ In that case an action by a mortgagee against the beneficial owners of land was dismissed because the mortgage had been executed under seal by the bare trustee of the beneficial owners. The Supreme Court affirmed that there is an established rule in our common law that an undisclosed principal cannot be sued on a contract executed under seal. The Supreme Court held that there was no justification to abolish the rule. It applied in the circumstances of the case and therefore the undisclosed beneficial owners could not be sued under a mortgage executed under seal by their trustee.

In circumstances where a mortgage is being taken on real property held in trust, it will be necessary, in order to avoid the possible application of the sealed contract rule, to ensure that the principal on whose behalf the mortgage is being executed is disclosed in the mortgage document. Likely the beneficial owner would also execute the mortgage so as to be bound by the covenants.

Summary

The lack of federal regulations prescribing that Nova Scotia law applies to security interests in offshore oil and gas assets is a fundamental concern under the current legislative regime respecting the area offshore Nova Scotia. As matters stand currently, there is no certainty that Nova Scotia’s *PPSA* applies when taking security interests in assets located offshore. Without the *PPSA*, there is no effective regime in place for securing, enforcing and determining priorities of security interests in many of the types of hard assets of an offshore oil or gas project. This issue will no doubt be addressed before, or in the context of, a major offshore financing as occurred in the Prince Edward Island fixed-link crossing project and the Hibernia Project off Newfoundland.

123. [2000] 1 S.C.R. 842.

Other issues that will arise in connection with taking security on assets of an offshore project will flow out of the structure of the project's joint venture, the terms and conditions of the project agreements between the co-owners, and the nature of the assets that will be taken as collateral. Consideration must be given as to how title is held in the assets. Are the assets held in trust by the project operator? What assets are capable of being taken as collateral under s. 426 of the *Bank Act*? Are any of the assets of the type that could be subject to a mortgage under the *Canada Shipping Act*? What assets can be secured by a *PPSA*-type security agreement? For purposes of registering financing statements to perfect security interest in such assets, it will be necessary to determine where the assets are located, and, in the case of intangibles, the location of the borrower's place of business or chief executive office.