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Freehold Mineral Rights in Alberta

Most mineral rights in Canada are owned by the Crown, but a minority are owned privately by individuals and corporations.

Two sets of rights exist for land in Alberta: surface rights and subsurface rights. The majority of the subsurface rights are owned by the Crown, but when Canada was first homesteaded, individual settlers were sometimes granted title to both the surface and subsurface. This practice was discontinued in the late 1880s. Land granted to the Hudson's Bay Company (HBC) and the Canadian Pacific Railway Company (CPR) also included mineral rights and some of these lands were subsequently sold to settlers, however, the granting of minerals of any kind with these sales was later discontinued.

Following Canada's pattern of development, the prevalence of freehold mineral ownership decreases moving into western Canada. In Manitoba approximately 75% of mineral rights are privately owned, compared to only 10% in Alberta. The corporate successors to the HBC and CPR own most of these mineral rights, but individuals and family corporations also own a portion.

Not all freehold mineral rights are the same.

Since today's freehold mineral owners obtained their mineral rights in different ways, not all mineral rights are identical. Some people have ownership of all mines and minerals, including both petroleum and natural gas, while other Certificates of Title may note that coal and/or petroleum are not included. The Certificate of Title from Alberta Land Titles will specify which minerals are held by the owner, if any. Gold and silver as well as surveyed water bodies and streams are always reserved to the Crown.

Freehold mineral leases are negotiated bilaterally between the owner and the company.

A company interested in exploring for oil or gas within mineral rights owned by an individual must first secure a freehold mineral lease agreement from the owner. The freehold mineral owner will typically be approached by a representative or land agent acting on behalf of the interested company. Whereas a licensed land agent must be used for surface lease negotiations, the representatives who negotiate with freehold mineral owners do not have to be licensed land agents under the *Land Agents Licensing Act*.

The Canadian Association of Petroleum Landmen (CAPL) encourages its members to attain and maintain the highest level of proficiency and ethical conduct through a professional certification program leading to a Certified Mineral Landman (CML) or Professional Landman (P.Land) designation. The CAPL's Ethics Committee is empowered to hear and rule on complaints against land agents holding either CML or P. Land designations. Individual freehold owners are encouraged to only deal with land agents holding a CML or P. Land designation, as this provides some recourse if inappropriate behaviours occur.

The company or land agent acting for the company often present the freehold mineral owner with a one page offer sheet outlining the bonus consideration to be paid to the owner for signing the lease, the term of the lease, the royalty rate to be paid in the event of production and, in some instances, the cap on deductions from royalties. The actual lease agreement with the detailed terms and conditions is often provided after the freehold owner has committed

themselves by signing and returning the offer sheet. Freehold owners are encouraged to request a copy of the actual lease agreement prior to signing the offer sheet.

Most land agents and the companies they represent use freehold lease agreements developed by CAPL. The CAPL standard freehold mineral lease editions are 1988, 1991, 1999, and 2014. CAPL 91 is used in most instances. CAPL 99 and CAPL 2014 are considered to be more freehold owner friendly lease forms, as they provide tighter controls on payment and offset well obligations. Many freehold mineral owners continue to be bound by leases negotiated prior to the advent of CAPL standard leases.

Companies have no obligation to use standard CAPL leases and may use other lease forms or make amendments to CAPL leases to suit their needs. It is not just the blank spaces for bonus, term, royalty rate and cap on deductions that can be negotiated. The other terms and conditions in the lease agreement can and, in some instances, should be negotiated. The form of the freehold mineral lease agreement itself may also be negotiated.

In negotiating a freehold mineral lease agreement, the freehold owner should understand both the terms and conditions in the lease agreement which has been offered to him and the technical circumstances surrounding his mineral rights. If possible, the identity of the company seeking to lease the mineral rights and its financial wherewithal should be assessed. This can be difficult for an individual not versed in oil and gas industry operations and contract law, which is why the Farmers' Advocate Office (FAO) strongly encourages freehold mineral owners to get legal and technical advice prior to signing.

The importance of the negotiation process cannot be overemphasized. Under the *Surface Rights Act*, surface owners have the opportunity to renegotiate compensation every 5 years if their impacts change, but no anniversary review occurs on freehold mineral leases. If it is established during the primary term of the lease that the well is capable of meaningful production, the lease continues for as long as that capability exists. Once there is production, the royalty structure remains the same indefinitely. Thus some freehold owners remain committed to rates that were negotiated 50 years ago. Only if capability of production is not established during the primary term does the freehold mineral lease expire.

When it comes to surface rights, the Right of Entry process under the *Surface Rights Act* provides a process wherein an energy company can gain access to private owner's land if an agreement cannot successfully be negotiated. There is no Right of Entry process for freehold mineral rights where the owner owns the entire spacing unit (typically one section for gas and one quarter section for oil). However, if a freehold owner owns less than the entire spacing unit and refuses to enter into a freehold mineral lease agreement with a company, the company can seek a compulsory pooling order from the Alberta Energy Regulator (AER) under Section 80 of the *Oil and Gas Conservation Act*. Such an order allows the company to drill without a lease from the freehold mineral owner.

A caveat reflecting the lease will be registered on the Certificate of Title.

The company will register a caveat on the freehold mineral owner's Certificate of Title to protect its contractual rights. A caveat must be registered as soon as possible because the priority on the Certificate of Title is given based on the date of registration, not the date of execution or lease date. The caveat registered against the Certificate of Title does not determine the rights (the lease does), but it will provide notice to other parties.

Leases can be transferred from company to another company throughout their life. As is the case with a surface agreement, the new company “steps into the shoes” of the previous company. The caveat on the Certificate of Title retains whatever priority the previous company had, and the new caveat holder must update the contact information on the Certificate of Title with Alberta Land Titles. If the agreement is changed or updated at any time, the caveat should be also be updated.

Compensation does not follow the structure under the *Surface Rights Act*.

A freehold owner is typically paid a small consideration upon signing, usually around \$10. Even though this is a nominal amount, it is important that it is paid. Once the caveat has been filed with Alberta Land Titles and it has been confirmed that no conflicting caveats exist on the Certificate of Title, the owner will be paid the “bonus” or “additional consideration”, which is typically quite a lot larger than the initial consideration. An owner may wish to clarify the timeframe within which the company anticipates that the bonus will be paid, as different versions of the CAPL lease have different provisions.

Once production is established, the owner will receive a royalty based on the royalty rate and the cap on deductions negotiated in the freehold lease agreement. In recent decades, negotiated royalty rates have varied between 12.5 % and 18%. However, in 2016 the Government of Alberta introduced a 5% royalty to be paid on Crown leases until the payout of the deemed drilling and completion costs of the well. This has impacted the amount freehold owners can negotiate in order to remain competitive with Crown mineral rights.

Many freehold owners want to know what constitutes fair compensation. The Farmers' Advocate Office (FAO) does not advise on compensation amounts for any type of negotiation, including freehold mineral rights. The Freehold Owners Association (FHOA) provides both technical, contractual and anecdotal compensation information to members. More information is available at www.fhoa.ca.

The lease can be continued after the primary term.

The length of the primary term of a freehold mineral is a matter of negotiation between the freehold mineral owner (the lessor) and the company (the lessee). The typical term is 3 years. The lease will also include a “habendum clause” that allows the continuation of the lease after the primary term. This is an important aspect of the contract because it provides the operator with the flexibility to continue operating after the primary term if the capability for production has been established. A freehold mineral owner should be aware that the habendum clause makes the length of the lease uncertain, as there is no way to predetermine when production or the capability for production will come to an end.

In the habendum clause, there are two ways a company can continue a lease after the primary term: through operating without cessation, or through the shut-in/suspended well clause of the freehold mineral lease. In order to continue most CAPL leases under the shut-in wells clause, the well has to be capable of meaningful production. Under these CAPL leases, payment under the shut-in wells clause is not enough to continue the lease. In general, there must be the capability of production in meaningful amounts.

Some non-CAPL leases do not have shut-in clauses, which is important because this means they can only be continued past the primary term through production. As always, this language

can differ greatly from lease to lease, particularly on pre-CAPL leases, and legal advice should be sought to examine particular situations.

A freehold owner who is negotiating should be mindful of the suspended well clause.

Suspended/shut-in wells are often an area of concern for freehold mineral owners. A well may be formally shut-in or suspended if it is not currently economically viable but may become so in the future. This practice is more common with gas wells than oil wells, as the connectivity of facilities in the area can be a big factor in making a gas well economical.

Under current Alberta legislation, a company is permitted to leave a well suspended indefinitely. During suspension, some contracts allow the company to continue the lease by paying \$1 per acre. Different contracts may contain alternative provisions. The CAPL 99 lease, for example, establishes an annual suspended well payment equal to the initial per acre bonus divided by the number of years left in the primary term of the lease.

Freehold mineral owners who are negotiating a new lease may try to incorporate a limitation for how long a well might remain suspended before the rights return to the owner. A freehold owner with an existing lease should have legal counsel examine the wording in the suspended or shut-in wells clause in their particular lease.

A freehold mineral owner may use the “offset wells clause” in the lease to force the lessee to take action if a well on an adjacent property produces commercial volumes of oil or gas.

Petroleum and natural gas move about in the subsurface in response to pressure changes. Production of oil or gas from any well results in a pressure reduction around the subsurface wellbore, causing oil or gas within the productive reservoir to flow toward the producing wellbore. This can result in oil or gas from one tract of mineral rights flowing into a wellbore on another tract of mineral rights.

The oil or gas produced from a well has no label indicating from where in the subsurface it originated. This inability to identify the source of produced oil or gas resulted in the early courts developing what is known as the ‘Rule of Capture.’ Under the Rule of Capture, a freehold mineral owner owns whatever oil or gas comes out of a well legally drilled on his lands, no matter where that oil or gas came from in the subsurface. Similarly, the freehold owner’s neighbour owns whatever oil and gas comes out of a well legally drilled on his or her lands.

The concept of ‘offset wells’ is tied to the Rule of Capture. As the freehold lease agreement deprives the freehold owner of his right to protect himself from drainage, most freehold lease agreements contain a definition of ‘offset well’ and an ‘offset wells clause’ which require the company to take action to protect the freehold mineral owner from drainage in the event of commercial production is being obtained from adjoining mineral rights. Although the company that has leased a freehold owner’s mineral rights may be contractually obligated to do something under the offset well provisions of the freehold mineral owner’s lease, offset well obligations are sometimes neglected and freehold mineral owners are advised to periodically monitor their mineral rights for offset wells.

The different versions of the CAPL lease have different provisions on the matter of offset wells. CAPL 91 provides protection from wells in laterally adjoining spacing units, whereas the later CAPL versions (99 and 14) provide protection from producing wells in both laterally and diagonally adjoining spacing units. Offset well provisions in freehold lease agreements are

complex. Legal counsel can provide advice on the precise wording that best suits your needs as a freehold mineral owner.

An owner could become responsible for freehold mineral tax if the company becomes insolvent.

Under the *Freehold Mineral Rights Tax Act and Regulation*, freehold mineral tax is payable to the Government of Alberta on production from freehold mineral rights by the individual freehold owner. However, almost all freehold mineral lease agreements stipulate that the freehold mineral tax is shared between the company (lessee) and the freehold mineral owner (lessor) based on the ratio of the company's working interest and the freehold owner royalty interest.

Alberta Energy provides a freehold mineral tax statement to the freehold owner and the company on or before March 25 each year indicating the amount of tax due based on production from the freehold mineral rights in the prior year. The statement designates a payor (typically the company) of 100% of the tax. The tax must be paid on or before April 25 in each year. The freehold mineral owner portion of the tax paid is typically recovered by the company out of future royalties payable. Freehold owners should be aware that if the company becomes insolvent prior to April 25 or refuses to pay, the freehold mineral owner must pay 100% of the tax or risk forfeiting their mineral rights.

Newer leases may have a deep rights reversion.

Some newer leases, including CAPL 2014, incorporate a deep rights reversion clause. After the expiration of the primary term, the rights to any formation below the deepest formation completed for production will revert to the freehold mineral owner. For the owner, this can be beneficial because it enables them to lease these rights to other companies. In order to alert other potential lessors to the availability of these formations, the caveat on the Certificate of Title should be amended to reflect the deep rights reversion.

The Freehold Owners Association (FHOA) is a good resource for freehold owners who are looking for information about leases, negotiations, and valuation of freehold mineral rights.

The FHOA is a non-profit association representing freehold mineral owners in western Canada. For a nominal membership fee, you can gain access to more information, attend seminars and the annual general meeting, and access other services provided by FHOA. The FHOA is continuously compiling freehold lease information on an interactive map that is available to members. For more information, please contact FHOA at 403-245-4438 or fhoa@shaw.ca.

Before you sign, get legal advice from a lawyer experienced in freehold minerals.

The FAO highly recommends obtaining legal advice from a knowledgeable and experienced lawyer for any freehold mineral negotiations or issues that arise. You can find a lawyer with expertise in freehold mineral rights by calling the Law Society of Alberta at 1-800-661-9003. They will provide the names of three lawyers, and your first 30 minutes of advice is free.

The FAO only provides general information on freehold mineral rights, limited to what is contained within this article. We do not provide recommendations on compensation or valuation amounts. If you are seeking more information on freehold minerals, please contact the Freehold Owners Association (FHOA) at 403-245-4438 or fhoa@shaw.ca.