

Advisory 2016-2:

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Farmers' Advocate Office (FAO) Warns Landowners about Selling Surface Leases

The Farmers' Advocate Office (FAO) has received reports that enterprises that are offering to buy surface leases from landowners. As an increasing number of operators face insolvency or other financial restraints, selling surface leases is apparently being promoted as a means of eliminating a perceived risk of landowners not receiving their annual compensation.

Concrete details about these proposed sale arrangements have not yet been obtained, and more information will be provided as it becomes available. At this point, the FAO strongly cautions landowners to consider the possible implications of selling their surface leases to enterprises:

- Recourse Available for Unpaid Rentals

To imply that no recourse for unpaid rentals is available is a misleading approach that capitalizes on landowner fears. In Alberta, landowners can obtain payment of their unpaid surface lease rentals through the Surface Rights Board (SRB) in the event that an operator becomes insolvent or refuses to pay.

Section 36 of the *Surface Rights Act* enables the SRB to terminate or suspend an operator's rights to site. If an operator is insolvent or refuses to pay, the SRB may direct payment of annual compensation from General Revenue until the reclamation is complete. Please see attached chart outlining the process for recovering unpaid rentals. More information is available at www.farmersadvocate.gov.ab.ca

- Ongoing Impacts

The annual compensation paid to a landowner is based on their impacts through *Loss of Use* and *Adverse Effect*. *Loss of Use* recognizes the fact that the landowner is no longer able to use the land under the surface lease, while *Adverse Effect* acknowledges the impact that the surface lease has on the remainder of the land, as well as the nuisance, inconvenience, and noise caused by the operator. A landowner will continue to experience these impacts from a site regardless of whether or not the surface rights are sold to third party.

Furthermore, selling a surface lease means conceding the right to renegotiate on the 5 year anniversary if the *Loss of Use* and *Adverse Effect* have increased.

- Not Realizing Full Value

At this point, the FAO has not confirmed what payout is being offered to landowners in exchange for their surface rights. Since a landowner has a right to be paid in full until the reclamation is complete, assigning the annual compensation to a third party in perpetuity may prevent a landowner from receiving full value in return for the impacts they experience during the lifetime of the development. Determining appropriate discount rates and present value for a potential sale is a challenging process and professional legal and accounting advice should be sought.

- Marketability of Property
Selling a surface lease to a private enterprise is a long-term decision. What appears attractive now may be detrimental to the marketability of the property in the long-term, as any new buyer would be faced with ongoing impacts from a tenant who is not required to pay them annual compensation.
- Control of Surface Lease
When a surface lease is assigned to a third party, the rights currently held by the landowner are also handed over. This has numerous possible implications.

For example, if you were prudent in your original negotiations and specified that the lease was for one well only, the new surface owner could open up negotiations for a second well or facility (providing the spacing requirements were met). In this scenario, you would receive notification for licensing as an adjacent landowner, but would not receive compensation or be engaged in the negotiation of the new surface lease.

- Tax Implications
The enterprises are promising the sale of surface leases on a “tax advantage basis.” No information is being provided on how this benefit may be received. Since taxes are complex and encompass a broad assortment of factors, landowners should obtain tax advice from independent tax professionals to understand the full implications of the transaction.
- Release of Private Information
Some of these enterprises are requesting significant personal data upfront with little or no commitment to confidentiality. Obtain a copy of the enterprise’s privacy policy before providing your personal information. Some disclaimers or consents enable those collecting the information to release it others.

Considering the shifts occurring within energy industry in Alberta, the FAO strongly encourages landowners to practice extra caution on any transaction relating to their surface lease at this time. Please contact the FAO if you have any questions.

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