INTRODUCTION TO WESTERN CANADIAN MINES & MINERALS OWNERSHIP

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INTRODUCTION TO WESTERN CANADIAN MINES & MINERALS OWNERSHIP

Topics to be Presented

- Who/What is CAPL (Canadian Association of Petroleum Landmen)
- Types of Land Ownership
- Origin of Western Canada Land Ownership
  - History of the Hudson’s Bay Company
  - The Sale of Rupert’s Land
  - Indian Treaties
- CP Railway (Main Line Land Grant & Settlement of Western Provinces)
- Soldiers’ Settlement Act
- Acquisition of Hudson’s Bay Lands by Dome/Canpar
- Fee Title Ownership
- Mineral and Royalty Trust Lands
- The Saskatchewan 1973 Stabilization and Development Act
- The Alberta Government Acts of “Expropriation”
- CBM versus Coal Ownership
- Poolings, Spacings & Such
- Royalties and other Reserved Interests
- Royalty Calculations, Deductions or No Deductions, what is the difference
- The Freehold Lease – What You May Not Know
Who/What is CAPL
(Canadian Association of Petroleum Landmen)

- A non-profit voluntary professional association for landmen in Canada, evolved from Alberta Landman’s Association founded by 8 members in 1948, and incorporated on May 23, 1961, today having over 1850 members (~1600 landmen, 60-70 student and 80-100 associate members).

- CAPL By-laws define professional landman as an individual with sufficient years experience in petroleum land negotiations – having responsibility and accountability for the negotiation of business transactions and/or the drafting of material, non-standardized agreements, all as relate to the acquisition, disposition, management or operation of mineral or surface rights.
  - Mineral Landman (A&D strategist, mineral rights negotiator, third party liaison, consultant in land tenure and related regulatory matters)
  - Surface Landman (planner/consultant/negotiator for surface access, ambassadors as face of industry for land owners)
  - Contracts Landman (interpret, negotiate and draft contractual content of land agreements)

- From inception, CAPL mandated to provide resources, access and opportunity to enhance and promote role of landmen in Canada: ~50 educational courses yearly, monthly publication of industry articles/news; structured mentorship and student scholarship program; input into educational institution curriculums and student body organizations; engage in public and government relations; liaison and work with various land owner, regulatory bodies and industry organizations—AAPL, CAPLA, PJVA, PADA, CAPP, EPAC, IRWA, AASLA, APEGA; public communication and community contribution—Alberta 4H Foundation, public relations booth at career fairs and holding rural open houses; promote fellowship and cooperation among members through meetings and association-sponsored activities; professionalism designations.

- CAPL widely recognized throughout the Industry for creating and maintaining industry-standard land agreements, such as the CAPL Property Transfer Procedure, Operating Procedure, Farmout & Royalty Procedure, Petroleum and Natural Gas Lease and Surface Lease. These documents have benefited our members and the Industry, as a whole, for many years.

- Role of landmen closely intertwined with land administrators (management of the land post-deal negotiation and agreement drafting), which group founded Canadian Association of Petroleum Land Administration (CAPLA). They perform the day-to-day administration of mineral leases, surface leases and agreements to track changes in land ownership, manage rentals and expiries, etc. Also often work closely with PJVA reps for production operations.
Types of Land Ownership

- Land ownership in Canada is held by:
  - Governments – federal or provincial (held in name of the monarch, called "Crown Lands")
  - Native Aboriginal groups
  - Corporations
  - Individuals

- Canada is the second largest country in the world at 9,093,507 km² or 3,511,085 mi² of land (more if fresh water is included). It occupies more than 6% of the Earth's surface. Land grants in Canada were primarily derived from English common-law, meaning the holder of title has a land tenure (permission to hold land from the Crown) rather than absolute ownership—this is important later when we talk about appropriation/expropriation of lands. Historically necessary so feudal lords did not create their own territories or countries once they obtained title to lands.

- About 90% of Canada's land (8,886,356 km²) is Crown Land, which may either be federal (42%, includes 1% Indian Lands) or provincial (48%). The remaining 10% is privately held by corporations or individuals.

- The provinces hold all “unclaimed” land in their jurisdiction in the name of the Crown—Over 90% of the sprawling boreal forest of Canada and Provincial Parks.

- Most federal Crown land is in the Canadian territories (NWT, Nunavut, Yukon), and is administered on behalf of Aboriginal Affairs and Northern Development Canada; only 4% of land in the provinces is federally controlled, largely in the form of National Parks, Indian Reserves and Canadian Forces bases.

- Until the Natural Resources Acts of 1930, the prairie provinces of Alberta, Saskatchewan, and Manitoba, and to a limited extent British Columbia, did not control Crown Lands or subsoil rights within their boundaries. This deprived them of the benefits of royalties from mining, oil and gas, or forestry. This was a major source of Western alienation at the time.

(Note: above info sourced from Wikipedia)
Origin of Western Canada Land Ownership

History of the Hudson’s Bay Company

- The Hudson’s Bay Company was incorporated by English Royal Charter in 1670-1676 as The Governor and Company of Adventurers of England trading into Hudson's Bay and functioned as the de facto government in parts of North America before European states and later the United States laid claim to some of those territories.

- It was at one time the largest landowner in the world, with the area of the Hudson Bay watershed, known as Rupert's Land, having 15% of North American acreage. It encompassed almost 8,000,000 km², including most of the prairies and parts of what are now northern Quebec, northern Ontario, and Nunavut. However, when this once powerful British fur trade giant’s business started to decline, it decided to try selling Rupert's Land to the Americans, thinking they would pay top dollar.

- The Americans had just paid Russia $7.2 million for Alaska in 1867 and were looking for other properties to expand the Republic and eyed the territory.

- The rapid expansion of the United States across the West alarmed many Canadian politicians who were justifiably afraid the United States would annex Rupert's Land. Several different groups throughout the American territories openly called for the annexation and believed that any expansion by Canada across the Prairies was detrimental to US interests.

- Beyond unification of the British colonies of Canada (New Brunswick and Nova Scotia) in 1867, most political parties also had expansionist views which called for the annexation of Rupert's Land. It was seen as the natural extension of its new nation which included Nova Scotia, New Brunswick, Ontario and Quebec, and made it clear to Britain that it wanted the territory to be sold to Canada.
Origin of Western Canada Land Ownership Cont’d

The Sale of Rupert’s Land

- Without Rupert's Land, Canada would be hemmed into the North-East corner of the continent, unable to tap into the resources and riches of the Prairies, limited to the narrow strip of arable land between the Great Lakes and unable to attract new immigrants to boost the population and drive commerce.

- Immediately following the proclamation of Confederation, the Dominion began negotiations with Britain and the Hudson's Bay Company for the acquisition of Rupert's Land.

- On March 20, 1869, the HBC reluctantly, under pressure from Great Britain, surrendered Rupert's Land in exchange for £300,000 Sterling (~$1.5MM) and 1/20th of all agricultural land in western Canada.

- HBC was granted sections 8 and 26 in most townships south of the North Saskatchewan River between Manitoba and the Rocky Mountains (approx. 4.5MM acres), plus the land adjoining all of its active trading posts to a maximum of 50,000 acres. The Charter and full control of Rupert’s Land was then transferred to the Dominion under the Rupert's Land Act of 1868 and the Northwest Territories Transfer Act in 1870.

- The sale involved roughly a quarter of the continent, but failed to take into account the existing residents - mainly Indians and Metis (this story is for another day).

- In 1926, the Hudson's Bay Company co-founded Hudson's Bay Oil and Gas Company Limited with exclusive right to lease all of the HBC Lands in western Canada. Further discussion on what happened to the HBC/HBOG Lands to follow.
Origin of Western Canada Land Ownership Cont’d

Indian Treaties

- After the creation of Manitoba in 1870, the Macdonald Government proceeded to establish the Northwest Territories Act to extend Canada's legal jurisdiction outside of Manitoba and made provisions for an administrative structure and application of Canadian law throughout the Territories.

- Fact remained that the Territories were devoid of any Canadian authority and was still the domain of Aboriginal people. Although the Dominion had purchased the title for Rupert's Land, it had no way of exerting its influence or jurisdiction over the area.

- As part of the obligations created by the transfer of the HBC Charter, the Dominion was responsible for addressing any and all Aboriginal claims to land.

- Dominion of Canada undertook negotiations to settle eleven treaties between 1871 and 1921 (the “Numbered Treaties”) so as to secure Aboriginal title throughout all of the Prairies, northern Ontario and the Peace River and Mackenzie River valleys (covering the area between the Lake of the Woods to the Rocky Mountains to the Beaufort Sea).

- The Numbered Treaties were land surrenders on a huge scale and promised reserve lands, annuities, and the continued right to hunt and fish on unoccupied Crown lands in exchange for Aboriginal title.

- In the eyes of the Federal Government, the treaties brought Aboriginal people of the Northwest under the jurisdiction of the Dominion of Canada and its laws.
Origin of Western Canada Land Ownership

Indian Treaties Cont’d

- Although all based on the 1850 Robinson Treaties model, the Numbered Treaties were not all identical—evolved over time and reflected negotiations of the differing parties' goals and hard fought desires.

- The early Numbered Treaties - Treaties 1 through 7 - became the vehicle by which the Department of Indian Affairs implemented existing and future assimilation policies in the Northwest.

- The earlier treaties had clauses similar to many of the civilization programs undertaken in central Canada to encourage the Aboriginal signatories to settle on reserve lands in sedentary communities, learn agriculture and receive an education by agreeing to provide schools or teachers and farming implements or live stock to assist the Aboriginal signatories in their transition to a life without the buffalo hunt.

- The latter treaties allowed for the opening of the North and access to valuable natural resources.

- The Numbered Treaties are largely responsible for the agricultural and settlement expansion across the Canadian Prairies, the construction of the transcontinental railway and affirmation of Canadian sovereignty throughout the NWT.

Western Provinces “Numbered” Treaties
Canadian Pacific Railway Main Line Land Grant

- With the acquisition of Rupert’s Land and as the numbered treaties were being settled, Sir John A. MacDonald makes an election promise of a railway from coast-to-coast in order to entice BC to join the Dominion.

- Canadian Pacific is hired to finish the Transcontinental railway from Winnipeg to the Pacific coast.

- Original land grant to CPR was $25 million + 25 million acres of land (outlined below in red, not all land was kept).
Settlement in Western Provinces

- William Cornelius Van Horne joined CPR in 1884 when very little progress had been made on the main line and the railway was clouded in scandal.

- Under his leadership, the line came in under budget and 5 years earlier than scheduled and the company commenced selling the lands to settlers.

- Canadian Pacific agents operated in many overseas locations and a few hundred posters like those below were developed to entice immigrants.

- They were often sold a package that included passage on a CP ship, travel on a CP train, and land sold by the CP railway. Land was priced at $2.50 an acre and up.

- These guys were very industrious in their goal to settle the prairies. The land in southern Alberta was too dry to farm so they developed irrigation systems—Lake Newell and Chestermere are man-made reservoirs both developed for irrigation. They even brought agricultural experts over from Europe that taught new farming techniques designed for the climate.
CPR Discovers NG

- While drilling a water well for steam engines, they hit gas—Alberta’s first gas well (CPR Langevin No. 1). After 1912, CPR stopped including the mineral rights in the sale of surface rights to settlers.

- Fast forward to 1914 and the famous Dingman #1 well is drilled in Turner Valley. Canadian Pacific started to lease out their minerals to oil and gas companies.

- Canadian Pacific determines there’s an opportunity to create more value for the company; so decide to become an active participant in the petroleum industry. They spin off a separate company to not only manage their oil and gas rights but to exploit their own land by drilling wells. In 1958 Canadian Pacific Oil & Gas is created as an E&P Company.

- In 1971, CPOG purchased a company called Central Del Rio Oils Limited that included fee titles in Alberta and Saskatchewan. The companies were amalgamated into PanCanadian Petroleum Limited and we all know how that story ends—Encana…..Cenovus/PrairieSky fee title lands.
Soldiers’ Settlement Act

- In the late nineteenth century the federal government, through the Department of Indian Affairs (DIA), had started facilitating the “appropriation” of reserve land in response to vocal and often powerful non-Aboriginal interests who wished to acquire land for farming, grazing, or speculation. This eroded large tracts of reserve lands to the detriment of the Aboriginal interests that the government was supposed to protect and conserve. The circumstances created by World War I conditions (the “stern needs of the times”) provided a rationale for this process to be pursued with new vigour. Indian land was appropriated (taken) first for the purposes of greater production during the war, and immediately after for non-Aboriginal soldier settlement.

- …such “idle” land, within the transportation belt and very pick of Western soil, could be put to much better use if settled by patriotic native sons - soldier settlers.

- The Soldier Settlement Board was established in 1917 and acquired over 85,000 acres of Indian reserve land in Western Canada to assist WWI veterans to set up farms. Lands and loans were given to any:
  - man who had served abroad with the Canadian Expeditionary Force;
  - former Canadian serviceman who had not left Canada but was in receipt of a service pension;
  - member of the Imperial, Dominion or Allied forces who had lived in Canada before the war; or
  - any member of the Imperial or Dominion forces who had served outside their own country and who had since emigrated to Canada,

    provided they first work on a Canadian farm for a time to prove that they had the capability to farm on their own, to have sufficient working capital to establish themselves, and to make a down payment of 20 per cent for land, stock, implements and buildings.

- Alberta and Sask were the most popular provinces for settlement, followed by Manitoba, BC and Ontario.

- All Dominion lands within 15 miles (24 km) of a railway were reserved for veterans. In the three Prairie Provinces, every eligible soldier was entitled to a grant of 160 acres (0.65 km²) and also had the right of any civilian to homestead a further 160 acres (0.65 km²).
Soldiers’ Settlement Act (Cont’d)

- Applicants for a loan were first investigated as to their fitness, moral character, assets and abilities. If they did not have sufficient farming experience, they could be asked to work on an existing farm for a period of time, and until May 1, 1921, could be given pay and allowances for such training, especially men with families. Special farm training centres were established in some places, but these were all closed in 1921.

- By 1921, nearly 60,000 applications for loans had been made, of which 43,000 had been deemed suitable. Loans were made at 5% interest and repayable in a) 6 annual instalments in the case of loans for stock and equipment, and b) 25 annual instalments for land and buildings.

- Loans to purchase land could amount to a total of $7,500, including:
  - up to $4,500 for land
  - up to $2,000 for stock and equipment
  - up to $1,000 for permanent improvements

- Loans on land already owned by the applicant could amount to a total of $5,000, including:
  - up to $3,500 for removal of encumbrances
  - up to $2,000 for stock and equipment
  - up to $1,000 for permanent improvements

- All settlers helped by the Soldier Settlement Board were regularly visited by field supervisors to check on their progress and provide advice. A Home Service Branch was established to give help and advice to wives, including free courses in home economics and farm subjects.

(Note: above info sourced from Wikipedia)
### HBC Lands Acquired by Dome/Canpar

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1926</td>
<td>The Hudson’s Bay Company co-founded Hudson’s Bay Oil and Gas Company Limited with exclusive right to lease all of the HBC Lands in western Canada to explore for oil and gas.</td>
</tr>
<tr>
<td>1974</td>
<td>Canpar Holdings Ltd. and Dome Petroleum Limited jointly acquired the assets of Siebens.</td>
</tr>
<tr>
<td>1979</td>
<td>Amoco Canada Petroleum Company Ltd. acquired Dome Petroleum.</td>
</tr>
<tr>
<td>1988</td>
<td>Canpar and Amoco exchanged certain assets whereby Canpar increased its mineral title ownership and royalty interests in the jointly held HBC Lands.</td>
</tr>
</tbody>
</table>
## Dome/Canpar Deal

### Canpar/Dome jointly acquire Siebens assets in Western Canada (1979)

<table>
<thead>
<tr>
<th>Unleased Non-Producing Lands (Canada Freehold Lands)</th>
<th>Leased Producing Lands (Canada Oil and Gas Lands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>100% of PNG &amp; related hydrocarbons assigned to Dome</td>
<td>Undivided 32.8% in M&amp;M titles conveyed to Dome</td>
</tr>
<tr>
<td>Canpar retains a 13.44% GOR in PNG, plus 100% of Heavy Oil, coal and other M&amp;M title</td>
<td>Canpar retains 67.2% in M&amp;M titles</td>
</tr>
</tbody>
</table>

Canpar’s retained interests were subject to a NPI and management fee payable to Provo, subsidiary of Dome. In 1983, NPI was converted to 65% of Canpar’s retained interests, resulting in interests:

- Dome/Provo 100% in PNG *
  - subject to 4.704% GOR to Canpar
- Dome/Provo 76.48% M&M title *
  - Canpar 23.52% M&M title

### Dec 1, 1993, Amoco/Canpar Rationalization (as to lands still owned by Amoco)

- Canpar GOR in PNG increased to 6.5% (incremental 1.796%)
  - Heavy Oil assigned to Amoco for 6.5% GOR
- Canpar fee title increased to 62.61%
  - Amoco retains 37.39%

*Notes:
- In 1988, Dome/Provo is acquired by Amoco.
- In 1992, as part of a large scale asset rationalization exchange, a 19.125% title interest in certain lands was assigned by Amoco to MT Partnership (comprised of Maligne Resources Ltd. and TCPL Resources, 50% each or 9.5625%), free and clear of Canpar ORR, NPI and mgmt fees. TCPL became Encor/Talisman. Maligne, subsidiary of Dow Chemicals, and Amoco combine assets/title interests to form Crestar.
- In 1993, Amoco’s Horizon acquisition and divestiture group sold Northern SK to Canadian Natural Resources (Boyer/North Central was sold to PennWest) and Southern SK to Fletcher Challenge Canada (Estevan block sold to Northrock/TAQA)
Fee Title Ownership

What is “Land Ownership” or an “Interest in Land”

- Estate in fee simple is largest and greatest estate in land granted by the Crown. Cannot be changed or stolen (almost). Common law rule that estate can only be take back by Crown if for the public good and if compensation paid (almost).

- An “owner of land” has all of the rights in or to a piece of real property (mineral or surface) that the law will recognize and protect. The word “title” is the evidence of that right of ownership—which, in the Western Provinces, will consist of simple fee title ownership granted by the Crown and evidenced by a Certificate of Title issued by the provincial Land Titles Office.

- An “owner of an interest in land” has only those rights which the owner of the real property grants to them; in which case, title will consist of the agreement by which they acquired the interest from the land owner, such as an easement, right-of-way or petroleum and natural gas lease granting the right to go on the land and produce – legally known as a “profit à prendre” (the right to win, take, remove).

- Common law used the following maxim to describe the legal concept of land: “To whomsoever the soil belongs, he owns also to the sky and to the depths,” i.e. ownership extends to both heaven and hell.

- Title to the surface area of land includes everything within the space formed by extensions of the surface property boundaries to the core of the earth and to the stars above (except that which is specifically excluded by operation of law or by contract). This concept is further considered as the “infinite carrot” theory, being that portion of the land from the surface to the centre of the earth constituting the root of the carrot and that portion from the surface to the sky (to infinity or heaven) comprising the foliage of the carrot.
The “Infinite Carrot”

Strict adherence to the infinite carrot theory would, for example, block aviation—regulations and courts have limited surface owner’s rights to only a height necessary for the ordinary “zoned” use and enjoyment of the land.

Air Space

Belongs to owner of surface rights

(lakes and navigable waters are reserved to the Crown and excepted out of land title)

Belongs to owner of mineral rights or “mines and minerals”

sand, gravel, clay, marls
coal, copper, iron, salt
valuable stone
minerals*
petroleum and natural gas

(*Note: although gold/silver are a mineral, it is not included in freehold minerals per Section 10 of the Mines and Minerals Act)

Piece of real property defined by legal description of the surface area and title includes everything within that space “from Heaven to Hell” unless specifically excepted out.

Surface clay and marls and sand and gravel on the surface of the land or obtained by stripping off overburden or excavating from the surface belong to surface owner.

Earth’s Surface

Sub-surface

Earth’s Center
What are Mines and Minerals

➤ In Alberta, minerals have been defined by statute (Sec 56 of the Law of Property Act) to include:

1. anhydrite 7. epsomite 13. mirabilite 19. shale
2. barite 8. granite 14. potash 20. slate
3. bauxite 9. gypsum 15. quartz rock 21. talc
4. bentonite 10. limestone 16. rock phosphate 22. thenardite
5. diatomite 11. marble 17. sandstone 23. trona
6. dolomite 12. mica 18. serpentine 24. volcanic ash

Note: although gold/silver are in fact a mineral, they are not included in the grant of freehold minerals per Section 10 of the Mines and Minerals Act.

➤ Courts have held that the word “minerals” also includes: petroleum, natural gas, coal, copper, iron, salt

➤ The meaning of “mines”, although not determined by statute, has been taken to mean the right to the space holding the minerals and could therefore be important for storage purposes, but mines and minerals title does not include pore space per Alberta’s Mines and Minerals Act, s. 15.1 (Dec 2010).

➤ Sec 57 & 58 of the Law of Property Act defines the surface title owner as owning:
1) surface clay and marls, and
2) sand and gravel on the surface of the land, and all sand and gravel obtained by stripping off the overburden or excavating from the surface.
Mineral and Royalty Trust Lands

➢ The late 1940’s were the golden years for conventional oil exploration in Alberta. The seismic technology used to discover the giant oil and gas bearing Devonian-age reef at Leduc in 1947 was applied throughout southern Alberta. Additional major light oil discoveries followed rapidly at Redwater, Stettler, Golden Spike and Bon Accord. By 1950, most of the available freehold mineral rights within the area of southern Alberta which came to be known as the ‘Golden Triangle’ had been leased.

➢ The oil discoveries of the late 1940’s not only changed the economic future of Alberta, but also made wealthy those freehold mineral owners whose mineral rights happened to lie within the area of the discoveries.

➢ Sometime in the late 1940’s, freehold owners within southern Alberta (and Saskatchewan) began to be approached by ‘entrepreneurs’ with a novel idea which purported to improve their chances of sharing in the benefits of this new found oil prosperity.

➢ At the time, a 12½% royalty was standard in lease agreements. The ‘pitch’ from the entrepreneurs involved the freeholder assigning the 12½% royalty interest to a trust company.

➢ The trust company would then issue share certificates—typically for a total 12½ units, each representing a percentage point of the 12½% royalty—to the freehold owner or to any other parties the owner indicated and manage disbursement of the royalty revenues to the unit owners (for a fee). Often referred to as a Royalty Trust (RT), Gross Royalty Trust (GRT, Gross Royalty Trust Account (GRTA) or Gross Royalty Trust Certificate (GRTC).

➢ Similarly, in some cases, the entire mineral interest was sold to the trust company and each unit typically equalled one gross acre, called a Mineral Trust.
The most active trust company was Prudential Trust (holding about 50% of the GRT’s). Others included Guaranty Trust, Security Trust, Montreal Trust and Royal Trust. Prudential and many other trust companies since acquired by/merged with Computershare.

Caveats were registered against the land title by the trust company to protect the unit owners and notify potential lessees or purchasers that the lessor royalty had been assigned.

The freeholder could keep or sell his units to third parties, trade them with other freeholders who had established their own GRT’s, or gift them to family members.

For the freeholders, most of whom were farmers struggling to make ends meet following the great depression, the sale of unit certificates provided much needed immediate cash. Typically, the entrepreneur promoting the GRT scheme would purchase several units. In addition, some energy companies made it a practice to acquire unit certificates from freehold owners (notably Scurry Rainbow Oil Limited).

In addition to the immediate cash advantages of selling units, the trading of unit certificates with other freeholders provided the freeholder with the opportunity to participate in successful wells even if no well or a dry hole was drilled on his mineral rights.

The trading of GRT unit certificates became so widespread that securities regulators became concerned and in 1957 the Alberta Securities Commission imposed restrictions on the trading of GRT’s. These restrictions largely put an end to the creation of GRT’s.

These units effectively became the same as a stock certificate and often became fractionated through further trading, subsequent settlement of estates when assigned to beneficiaries, etc. For example: 1/10th, 1/100th or even smaller fractions of a unit.
The earliest GRT agreements were kitchen-table types of agreements. As time passed, the agreements were refined by the various trust companies that became involved.

For 30 years, from 1950 – 1980, energy companies that had established production from mineral rights leased from a freeholder whose mineral rights were burdened with a GRT accounted to the GRT trustee for the 12½% royalty assigned under the GRT and the trustee then accounted to the holders of unit certificates in the GRT. No questions asked about validity of the trusts or whether the holders of the units were entitled to the money.

THEN, in 1987, the issue of whether the royalty interest assigned to the trustee in a GRT agreement was an interest in land or merely a contractual right came before the Court of Queen’s Bench of Alberta.

In Guaranty Trust Company of Canada v. Hetherington, the trial judge ruled that the royalty assigned was not an interest in land as it applied only to the royalty in the lease which existed at the time the freehold mineral owner had entered into the GRT and any other leases entered into by that mineral owner, but would not apply to leases entered into by successors or assigns of the mineral owner.

“The Owner hereby covenants and agrees … that, in the event that any lease that may be in existence as at the date of this Agreement is cancelled for any reason, or in any event that no lease is in existence as at the date of this Trust Agreement, he shall and will in negotiating any lease or other instrument for developing the said lands reserve unto the Trustee the full 12 1/2% Gross Royalty hereby assigned to the Trustee”.

The appeal court further ruled that, if the GRT expired by effluxion of time and was not ‘cancelled’ [not terminated, expired, surrendered], it would not apply to subsequent leases. This “inferior” form of GRT was used by Prudential Trust primarily in the 1950 – 1952 period and became known as a PTC-1.
Subsequently, “superior” forms of GRT agreements evolved. In 1990, the Court of Queen’s Bench ordered a trial of test cases to resolve the interest in land issue. In Scurry Rainbow Oil Ltd. v. Galloway Estate, the trial judge considered the issue of whether a GRT gave rise to an interest in land or a contractual interest in looking at forms other than PTC-1. In all instances the trial judge ruled that an interest in land had been created. On appeal, the trial judge’s ruling was upheld by the Alberta Court of Appeal. All other GRT’s which have been litigated have been found to create interests in land.

Examples of superior forms:

• “In the event that the lease herein before mentioned is cancelled, terminated or in any manner whatsoever brought to an end, the Owner agrees that ...the said lands shall continue to be subject to a twelve & a half (12½) percentum gross royalty...”

• “Grantor covenants and agrees that he will not himself produce, nor permit any other person to produce, nor enter into any agreement which would permit the production of, any of the substances therefrom unless there by reserved, assured and transferred to the Trustee such gross 12½% thereof...It is the intention of the parties that the interest in the said substances herein conveyed and transferred to the Trustee represent at all times a royalty interest of 12½% of the substances produced and saved from the said lands whether under the said Lease or otherwise...”
The Saskatchewan 1973 Stabilization and Development Act

- Effective Jan 1, 1974, the SK Crown “acquired/expropriated (stole)” all PNG down to base of producing zone (referenced under the land titles as to certain depth in feet below mean sea level) in each DSU from any fee title owners holding more than 1280 acres.

- If Lessee’s did not have a caveat on title protecting their leased rights as to these shallow rights at that date, they lost their claim to these rights.

- SK Crown deemed the existing royalty null and void and arbitrarily imposed Crown Land equivalent royalty.

- Partial lessor rights under existing leases were never assigned to the Crown. Under the Act, they were “deemed to be transferred to and vested in” the Crown (by law of segregation, removed from the existing title and lease).

- In 2009, Crown started sending out letters to lessees asking if they want new Crown Lease issued “before expiry of the term of a lease”, and asked to provide copy of existing lease — watch out if there’s anything in that lease that suggest it’s dead due to gaps in the shallow production or continued only based on deeper production – suddenly, your leased rights become open Crown rights!

- Similarly, if original lease was continued by shallow production, does this still have any basis for continuation of deeper rights, with no privity of estate between the freeholder and lessee as to the shallow rights and no financial benefit to the freeholder?

- Warning: take a new lease for the deep rights before drilling a very expensive well.
The Alberta Government Acts of “Expropriation”

Bill 24 Carbon Capture and Storage Statutes Amendment Act and
Bill 26 Mines and Minerals (Coalbed Methane) Amendment Act

➢ Both came into force December 2, 2010, against rights of fee simple owners in Alberta.

➢ We are all surely aware of Crown’s ability and willingness to change the rules with lack of consideration or compensation for bonus paid by lessees when, through legislation, they introduce deep or shallow rights reversion, remove “oil sands” from PNG leases, change the royalty regime, etc. All not against the law given nature of limited leasehold estate acquired under a Crown lease.

➢ However, common property law dictates that there is to be compensation if title is expropriated (for the public good) from a fee simple owner.

➢ Both bills state, firstly, “it is deemed for all purposes...that no expropriation occurs as a result of the enactment of this section”; and, “no person has a right of action and no person shall commence or maintain proceedings; (a) to claim damages or compensation...(b) to obtain a declaration that the damages or compensation...is payable by the Crown, as a result of the enactment of this section.” Presumably, defending these Acts as simply providing “clarity” of fee ownership as initially granted.

➢ Bill 24—Crown takes back “pore spaces” for disposal, injection or storage purposes. Removed any ambiguity and liability for the fee owner with respect to CO₂ sequestration to move CCS projects along; but also, consequently, takes away any “profit à prendre” revenue to the fee owner for same. Still a requirement to obtain consent of fee owner and discretionary whether for a “fee”.

➢ Bill 26—Crown “clarifies” that CBM “is hereby declared to be and at all time to have been natural gas”, stripping away ownership of CBM from the owner of coal rights.
CBM versus Coal Ownership

- Due to the CBM/Coal uncertainty before Bill 26, many private agreements were entered into between parties to clarify or split out ownership of CBM.

- Bill 26 “…does not affect a provision contained in any conveyance, agreement, agreement for sale, lease, licence, permit or other contract made subsequent to the original disposition from the Crown of natural gas rights in any lands by: (a) the owner of the title to the natural gas…or (b) any person holding natural gas rights through the owner of the title…that specifically grants rights in respect of coalbed methane to the owner…or to any person holding coal right through the owner of the title to the coal.”

- Where a freehold lease excludes “coal” from the leased substances, it is still unclear whether in fact the entirety of the coal seam and therefore the CBM is excluded—so, before drilling CBM wells, should get clarification/ratification agreement from fee owner that the CBM is included (caveat the lease amendment).

- PNG rights previously leased or sold “excluding CBM”, are still excluded if adsorbed in a coal seam.
Poolings, Spacings & Such

- Most leases/royalty agreements allow for pooling to complete a Spacing Unit without prior consent of LOR/GOR owner.

- Pooling includes combining lands, zones, substances with other lands, zones, substances—not always based on acreage contribution to complete a DSU. In case of commingled production, need common ownership or production allocation agreement.

- Pooled lands are either cross-conveyed (exchange of ownership and liabilities) or non-cross conveyed (apportionment of production based on proportionate acreage).

- For Holdings or Increased Well Density in AB, regular DSU unchanged (i.e. ¼ sec oil, 1 sec gas)—all ownership in DSU still needs to be held in common or pooled. SK regs redefines size of DSU.

- No such thing as a Horizontal Well Spacing Unit—productive HZ segment crossing any land boundaries where ownership not held in common, is not pooled to complete DSU and requires a production allocation agreement.

- AB Crown regulations require a production allocation unit agreement (PAUA), well by well, for HZ well production to be allocated across diversely held lease boundaries based on “open hole lengths on each tract”.

- SK Crown issues amendment to lease for pooling of Crown lands with FH lands for HZ well production to be allocated based on areal extent of the “cigar” drainage area contained within the diversely held lease boundaries.

- Freehold to freehold not bound by these regulations or policies, nor is freehold owner obligated to sign off on Crown dictated allocations. This is not unitization of lands as contemplated by provisions of the lease, so lessee not free to unilaterally allocate the production based on these regulations or policies. Need written agreement from freeholder to amend the lease for allocation of production and payment of the royalty.
In above example of single LSD spacing, minimum inter-well set-back is 150m, so 75m drainage radius (1/2 of minimum set-back) is used for calculating the ultimate drainage area (UDA) of the productive interval of the well. Each legal subdivision (LSD) within the drainage area is a ‘tract’. The tract for each LSD is based on percentage of the UDA within that LSD. In this case, LSD 1 would be allocated production in accordance with A% of the UDA, LSD 2 would be allocated B%, and LSD 3 would be allocated C% of the UDA. For 2nd HZ, Crown would issue new lease amendment to pool LSD 2, 3 & 4.

In above example, LSD 4 of Section 26 is now included in the drainage area. Each LSD within the drainage area is still a tract, but the allocation of each tract is divided evenly within each vertical drainage unit. In this case, LSD 1 and LSD 2 are each is allocated A/2% of the UDA and LSD 3 and LSD 4 are each allocated B/2%. The total allocated percent of production will add up to 100%. For 2nd HZ, lands already pooled, so SK Crown does NOT normally issue new amendment to re-apportion production from a new well on same pooled lands.
Royalties and other Reserved Interests

- **Lessor Royalty (LOR)**
  - The lessor royalty is a reserved share of the minerals and/or a rent for the granting of “profit à prendre” to the lessee and reverts back to lessor at expiry of the lease.

- **Overriding Royalty (ORR/ORRI)**
  - An overriding royalty is a grant or reservation out of the lessee's working interest entitling its owner to:
    1. a percentage of the minerals/production or
    2. the right to receive a share of the proceeds from sale of production, both free of drilling, completing, equipping and operating costs.
  - Difference is whether the royalty is an interest in land depending on two criteria: (1) did the party creating the royalty have an interest in land (freeholder or lessee), and (2) did the parties intend the royalty to be a grant of interest in land (i.e. right to take in kind) rather than a contractual right to a portion of the proceeds from the oil and gas substances recovered from the land?
  - Gross Overriding Royalty (GOR/GORR) means a gross percentage share of the minerals/proceeds.
  - Net Overriding Royalty (NOR/NRI) means a percentage of the WI share after netting out other specific interests or burdens.

- **Net Profit Interest (NPI)**
  - The right to a percentage of the gross cash income from the sale of production less all expenses (capital costs, production & operating expenses, other royalties) incurred to produce the income.

- **Net Carried Interest (NCI)**
  - Basically an automatic “non-participation election” until recovery from revenues of 100% or more of costs & expenses.

- **Production Volume Royalty (PVR) or Volumetric Production Payment (VPP)**
  - The right to receive a fixed production volume (over fixed time period) or to recover a certain cash amount from production proceeds.
**Royalty Calculations, Deductions or No Deductions, what is the difference**

- Unless different percentage royalty rates are specified for each product, all products obtained from a gas well (ethane, methane, field condensate and NGL’s) are subject to same rate.

- Allowable deductions for “all products” from a Gas Well will typically depend on the specific point where the “value” of the royalty share of production is to be determined.

- The concept of Current Market Value is that even though the gas is typically sold at the Sales Gas Meter Station (NOVA), you can determine the value at various points between the Wellhead and the sales point by deducting the actual costs for the various processes between those points. Think of it this way – what price would a buyer be willing to pay me if they bought the gas at the wellhead instead of at the NOVA Meter station? The buyer WOULD want to deduct the costs he will incur for well site separation and compressing, gathering, processing, treating and transporting the gas.

- If gas was to be sold at the Point of Measurement instead of the Wellhead, then a buyer WOULD deduct their costs for compressing, gathering, processing, treating and transporting the gas, but NOT for well site separation. Most agreements provide that “removal of basic water and sediment” prior to Point of Measurement is at operator’s cost.

- If the agreement allows for gas deductions at all, it will usually specify determination of value either at the Wellhead or the Point of Measurement.

- If agreement specifies that there are to be “no deductions/all without deductions whatsoever, etc.” or determination is at Point of Sale, then value is gross sale proceeds.
TYPICAL WET GAS WELL FLOW AND ROYALTY/DEDUCTION DETERMINATION POINT
Royalty Calculations, Deductions or No Deductions, what is the difference Cont’d

- Unless different percentage royalty rates are specified for each product, all products obtained from an oil well (crude, solution gas and related NGL’s) are subject to same rate. Note: under CAPL agreements, Crude/Oil is often separated from “all other”, such as the typical 1/150 (min 5%, max 15%) oil, 15% other—monthly crude oil volume measured in bbls/150 = % (or m³/23.8365)

- Same as for gas, allowable deductions for “all products” from an Oil Well depends on the specific point where the “value” of the royalty share of production is to be determined.

- For oil, the Point of Measurement is usually at the outlet of the production tanks, after well site separation and removal of basic water and sediment.

- If we decided to take our oil in kind at the wellhead, the buyer would deduct the costs they would have to pay for wellsite separation, transportation costs and/or clean oil trucking costs to get the oil delivered into the feeder pipeline where it is sold.

- If the oil was sold at the Point of Measurement (the production tanks), the buyer would deduct the costs for transportation and/or clean oil trucking. Many agreements allow for “clean oil trucking only”, but do not contemplate pipeline transportation costs.

- Value at the Point of Sale means no deductions at all unless specified—the agreement may also state “without any deductions whatsoever” or “without any deductions other than clean oil trucking”.

- Time and Place of Production = Point of Measurement

  - In Amerada Minerals Corporation v. Mesa Petroleum (N.A.) Co., Court concluded “time and place of production” is the point where crude oil and natural gas are separated and each separate product can be measured, its value can be tested and where it can be effectively stored and used. The Court specifically stated “the place of production is NOT the place at which actual severance from the ground takes place (i.e. is not the wellhead)”.
TYPICAL OIL WELL FLOW AND ROYALTY/DEDUCTION DETERMINATION POINT

Oil Well

Separator Dehydrator

Production Tank

Crude Oil

Gas Plant

Emulsion

Crude Oil

Raw Gas

Waste Water

Wellhead
(Deductions “A” + “B”)

Point of Measurement
(Deductions “B”)

“A” Separation, removal of basic water sediment

“B” Clean Oil Trucking

Clean Oil Trucked to Pipeline

Clean Oil Pipeline Connected

OR

Feeder Pipeline

Entry Point to Feeder Pipeline
(No Deductions)
The Freehold Lease – What You May Not Know

- **Split Titles**: Condensate/NGL’s (even trace oil) from a Gas Well belongs to owner of NG title; Solution Gas and related Condensate/NGL’s from an Oil Well belongs to owner of Petroleum title—issues arise for gas caps, gassy oil wells or oily gas wells when leases not held for both.

- **GRT's**: Serious issues can arise if freehold owner is unaware that his mineral title is burdened by a GRT. For instance, during 2003–2009 when CBM was a focus of industry activity in south central Alberta, a number of developers insisted on leases with sliding scale royalties of 6% to 18%, depending on monthly production volumes. Typical GRT’s are a fixed 12½% royalty payable to the trustee regardless of royalty negotiated under a new lease. Particularly, if using a CAPL lease form, the 12½% royalty assigned to the GRT is a “prior disposition” and in each of the ‘88, ‘91 and ’99 form, the freeholder is responsible for any prior disposition payments out of the royalty. That freeholder could have to pay more out of his own pocket (up to 6½% more) than he receives from the lessee in low productivity situations.

- **Continuation—90 days’ cessation**: Depending on vintage, some leases may terminate automatically if production is ceased for period greater than 90 days. Application of shut-in provisions can vary and be dependant on “capability of production”, “intermittent market”, etc. Simply making the shut-in payment is not always enough.

- **Offsets**: Most often a covenant (promise) to act, not requiring notice or action by lessor to “activate” the lessee’s obligation to satisfy offset as of “trigger date”— compensatory royalties retro-active.

- **Amendments**: Can amend most terms of a lease other than the grant of rights (cannot add to or remove PNG rights originally granted at time of lease or change date of the grant – note earlier point regarding “clarification/ratification of CBM rights” as having been originally intended, not added).

- **Caveats**: Needed on title to protect interest claimed in and to mineral rights pursuant to a PNG lease—must file new caveat for any amendment to the lease (i.e. term extension).
The End