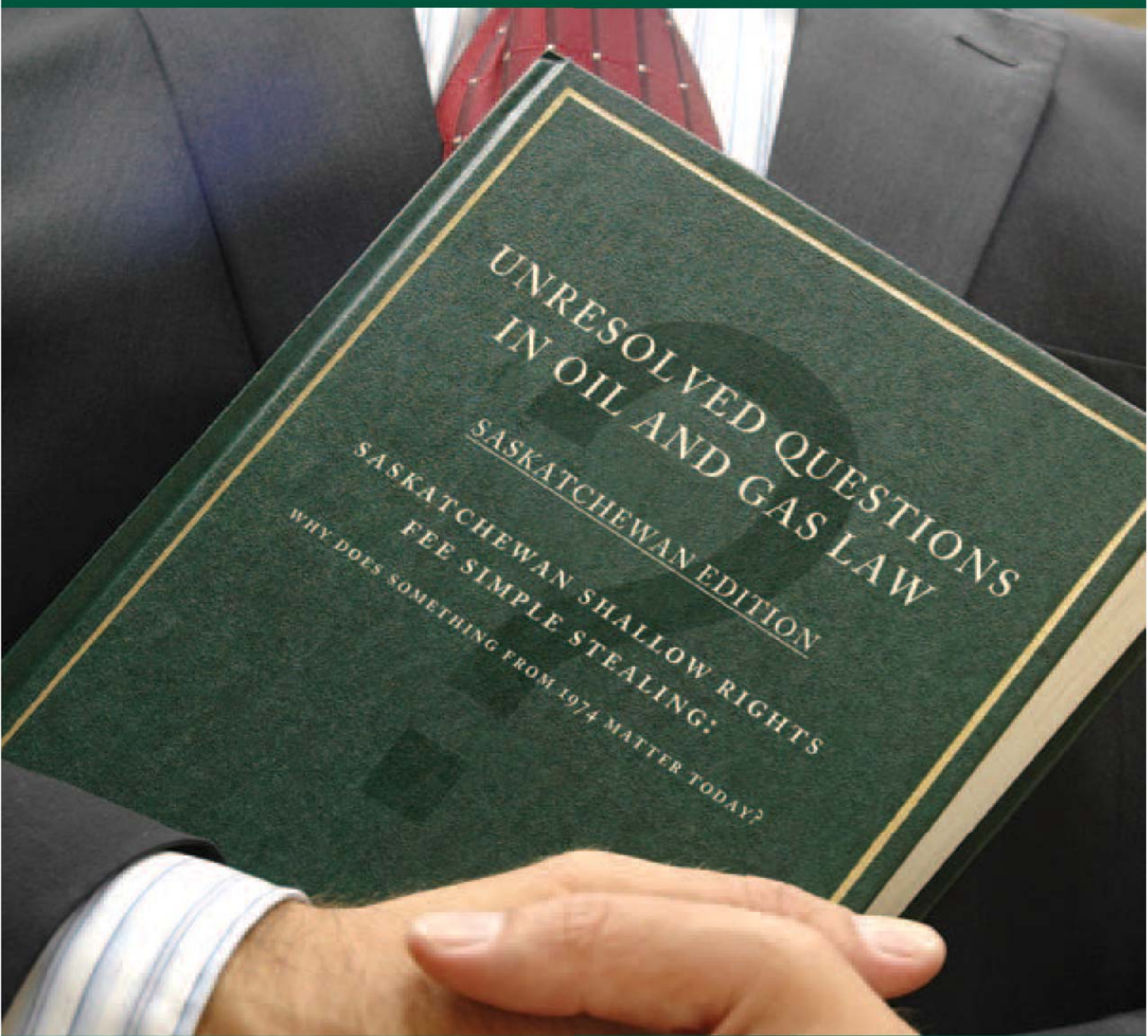


THE NEGOTIATOR

capl

The Magazine of the Canadian Association of Petroleum Landmen
October 2011

capl



Archaeology and the Oil and Gas Industry in Northeast B.C.

Balancing Natural Resource Needs and Heritage Resources in Northeast B.C.

The Negotiator's Mindset

Negotiations Basics

Negotiator's Notebook

Planning and Evaluating the Agreements You Negotiate



Saskatchewan Shallow Rights Fee Simple Stealing

(Why Does Something From 1974 Matter Today?)

THIS IS A FOLLOW UP ARTICLE TO MY DISCUSSION IN THE MARCH 2011 *NEGOTIATOR* OF THE ALBERTA CROWN STEALING OF PORE SPACES AND CBM RIGHTS FROM FEE SIMPLE OWNERS. Not sure why I am fixating on Crown stealing lately. Must be turning into a grumpy old man.

The Saskatchewan stealing is, in my view, the bestest ever example of Crown stealing of mineral rights. I speak, of course, of the unprecedented stealing of all large company held producing fee simple PNG title under the *Oil and Gas Conservation, Stabilization and Development Act, 1973* (the "Act").

Very interesting old man, but why should I care about something that happened before I was born? Ahhh, young (mouthy) grasshopper, in this case the past does matter and it might just bite you in the butt.

This Crown stealing is material today for lots of reasons. We will focus on two issues:

- the fairly recent SER process of issuing letters asking if oil companies wish to convert their Crown acquired leases to a shiny new Crown lease; and
- the drilling of deep oil wells (think Bakken) under freehold leases where the shallow rights are Crown acquired.

There are material legal risks associated with both of these scenarios that a diligent landman must be aware of.

Quick Overview of the Stealing (Crown Acquired Lands)

Under the Act, effective January 1, 1974 the Crown stole certain mineral rights from all large fee simple mineral owners in the province (excepting anyone holding under 1,280 acres). The key expropriation terms are as follows:

- all PNG “down to and including the producing zones”; from
- each “Producing Tract” (spacing unit/drainage unit); shall be
- “deemed to be transferred to and vested in” the Crown.

This is what the old landmen in your office mean when they refer to shallow rights in old oil well spacing units in Saskatchewan being Crown acquired. Remember, this was a stealing of the lessor’s interest, not the lessee’s interest.

Stealing the Fee Simple Title

Over the next 10 years or so, Saskatchewan Energy and Mines (now SER) went further in the stealing and sent letters of instruction to the Land Titles Office directing that the expropriated shallow rights be stripped from the existing mineral title of the fee owner and set up in new Crown fee simple mineral titles. This resulted in the, oh so popular, mineral titles in the name of the Saskatchewan Crown which pertain to:

- PNG rights (not all mines and minerals); for
- each distinct spacing unit (usually one or two Lsds); from
- the surface to some goofy depth described on title as “XXX feet below mean sea level”.

It is beyond the scope of this article, but there are numerous tricks and problems with the Crown mineral titles being stratigraphically described as “XXX feet below mean sea level”. I give a very witty lunch and learn presentation that goes through this issue, together with the further complexity resulting from the creation of New World Mineral titles that often do not fully describe this

stratigraphic description. The take away thought for today is that if you are drilling a horizontal well at or near the depth of the producing zone of the old well that defined the stratigraphic expropriation, you may have problems determining if you are drilling on Crown acquired lands or the deep rights lease.

Initial Impacts On Lessees

A lessee holding a standard surface to basement PNG lease in 1974 must have been a bit bemused by the Crown stealing. Bottom line was that you now had producing shallow wells where you had to pay royalties to the Crown. Complexities were many, including:

- the lessee’s rights are only protected if a caveat protecting the lease was on title at the time of the expropriation. This is still very much an issue today. Caveats filed after January 1, 1974 will not cut the mustard. No caveat means no interest in the shallow rights.
- the freehold lease must be valid and subsisting for you to have any rights. If you had a dead freehold lease at the time, the Crown stealing does not save you.
- the Crown was good enough to ignore your current royalty (typically 12.5%) and instead deem the royalty payable to be a Crown equivalent royalty.
- the Crown never prepared an assignment of leases for the shallow rights. This is an important issue which we will discuss below. They simply stole the rights.

Do I Want A Shiny New Crown Lease?

The Act always provided a mechanism whereby the lessee could apply for a Crown lease of the Crown acquired shallow rights. From an administrative point of view this is desirable as a typical Crown lease creates a normal lease split and a standard link to the Crown royalty payable and Crown lands. Trying to set up splits for Crown acquired rights has always been a huge hassle.

In practice I never saw a single Crown lease issued and was never able to find anyone at SER that would undertake the project. That is until 2009 when SER started to send letters out to oil companies offering to issue Crown leases. Please note that the



Surface Land Specialists

Land Acquisition | Land Administration
Public Consultation | Regulatory Compliance
Environmental Field Reports

LANDWEST
RESOURCE SERVICES LTD.

780.679.4222
www.lwrs.ca

conversion letters indicate that conversion of a Crown acquired lease to a Crown lease can be requested at any time “before the expiry of the term of a lease”. The Crown then follows up and asks for a copy of your existing freehold lease.

You know, they want a copy of that super crappy old 1950 vintage freehold lease with the awful continuation language. I know a Crown lease sounds like a really nice way to clean up your files, but you need to be very, very careful before you start down this path. Especially if you are:

- missing your caveat;
- have gaps in shallow production; or
- are relying on deep production to continue the lease.

If so, you will not want to take up the nice offer of conversion to a Crown lease. This is because, if the Crown puts any effort at all into reviewing your lease, title and production history prior to issuing a Crown lease, you may end up in the awkward position of having the Crown deny your application for a Crown lease and inform you that you no longer have any shallow rights.

Additionally, if you hold both the shallow and deep rights under the existing freehold lease, conversion of the Crown acquired shallow rights to a Crown lease will almost certainly result in the extinguishment/surrender/termination of the shallow rights portion of the freehold lease. This means that if you only have shallow production, obtaining a Crown lease could kill your deep rights under the lease as you have no production to continue same.

Deep Rights Termination

The question then becomes (absent acquiring a new Crown lease) have your deep rights terminated in the factual scenario where you are the lessee under a Crown acquired lease and are relying on shallow production to continue deep rights under the lease.

Commonly, shallow production has continued merrily along for 3035 years and no one ever considered the effect of the split on the continuation mechanism under the lease. No one really even looked at the deep rights as being valuable. Then the Bakken and other deeper rights oil plays come along and lots of people drilled

under the deep rights split of the freehold lease without first considering whether the lease was valid and subsisting.

“Said Lands”

First the argument that all is peachy. If you have shallow production under the lease, such production is from the “said lands” as defined in the lease and hence your entire lease is valid and subsisting. Almost none of the affected leases have deep rights reversion so that is not an issue. Very simple. All done. Go ahead a drill a \$4 million dollar horizontal Bakken well. Why bother with a costly lawyer.

No Freehold Lease Segregation

This all peachy view can be supported by the fact that at no time did the Crown sign a formal assignment of lease and become a recognized party to the freehold lease. Rather, the Crown expropriated the PNG rights and expressly preserved the rights of lessee’s under existing freehold leases.

Since the Crown may not have contractually become a lessor (i.e. no novation occurred), it follows that the prior lessor is the only recognized lessor under the lease. Ergo, it follows that segregation has likely not occurred so that we have one lease, not segregated deep and shallow leases. Hence a shallow well (or a shallow unit) may continue the entire lease including deep rights.

Very tempting argument for a lessee who holds the deep rights and now wishes to drill them.

Expropriation of the Subject Matter of the Lease

But for the life of me, I cannot get to the point where all is peachy. The problem is that the entire subject matter of the lease was stolen from the lessor and expropriated by the Crown. This is because:

- the Act specifically states that the shallow rights are “deemed to be transferred to and vested in” the Crown.
- the fee mineral title for the shallow rights was removed from the existing title and a new title was created in the name of the Crown.
- all shallow production royalties have been paid to the Crown for the last 37 years and hence the freehold lessor will have received absolutely no financial benefit under the lease.

Service, Dependability, Efficiency and Flexibility




... ALL COME STANDARD

- Freehold Mineral Leasing
- Crown Land Sales
- Surface Land Acquisition & Regulatory Compliance



Suite 1300, 734 - 7 Avenue, SW Calgary, Alberta T2P 3P8 403.265.1116 www.standardland.com

StandardLand
We make your job easier.

- the Crown has administered the shallow rights as if it was the full owner under a new agreement. Crown royalties apply. Crown offsets apply. And now the Crown is offering “replacement” Crown leases.

First off, the wording “*deemed to be transferred to and vested in*” under the Act smells a lot like novation or segregation to me. In our legal system, the Crown has the authority to “deem” itself to be a party to a contract or steal interests in land. Crappy but true. Hence, I am suspicious that such language serves as a novation or segregation even where a formal assignment of lease has not been prepared.

In no real sense does the current lessor have any say with respect to the shallow rights under the lease. Nor does the lessee have any real contractual relationship with the lessor with respect to the shallow rights. The Crown simply ripped the guts out of a portion of a contractual relationship between two private parties and kinda left the parties to figure out for themselves what rights, if any, remain.

Further, the estate or interest in land that supports the *profit a prendre* (the right to win take and remove) under the lease is no longer held by the lessor but rather title (the estate or interest in land) is vested in the Crown.

So I end up in this awkward situation where there is simply nothing left of the shallow rights portion of the lease. There is no contractual nexus between the lessor and the lessee and there is no privity of estate between the fee simple mineral owner and the lessee.

The unresolved legal question is whether, on such a set of facts, the shallow rights portion of the lease continues to exist. The bar is not very high, it merely needs to exist in the sense that shallow production will continue the deep split. That is not asking for very much, but I simply cannot shake the feeling that there is nothing left of the shallow rights. If I’m right, the deep rights portion of the lease can be continued only with respect to the “said lands” that remain in existence between the parties, namely the deep rights.

I am not much for equity, but it does not seem very fair to the lessor to say, I know the Crown stole your shallow rights and you have been receiving no royalties for 30 years, but you know what, tough tomatoes. I can continue the deep rights under the lease and never pay you a dime. Even better, at any time I can go ahead

and drill the deep rights and keep the deep rights split alive with shallow or deep production. My choice.

Many of the corporate lessors holding title to deep rights are aware of the issues and are often amenable to executing new deep rights leases in order to resolve the legal uncertainty that can hold up drilling of new horizontal wells on their lands. To be clear, the issue is uncertain for both the lessor and the lessee. There exists:

- not only uncertainty for the current lessee in drilling under an existing deep rights lease, but also
- uncertainty for the current lessor who assumes that the deep rights have terminated and issues new deep leases where we know a prior freehold lease existed at the time of Crown expropriation. Especially if there is a prior caveat on title.

Neither the lessor nor the lessee is in a good position to push this issue without a court action. Somehow, we have muddled through the last 37 years without anyone filing a statement of claim. Either ignorance is bliss or people are working through this issue on a lease by lease basis.

The tough choice for the current lessee is to measure the cost of a new lease (including more onerous terms and continuation restricted to deep production only) versus the risk of just drilling and one day receiving a nasty letter in the mail from the deep rights fee owner claiming trespass.

No easy answer on how to proceed.

Totally Novel and Screwed Up Issue

A quick proviso before I end. It is very difficult to give straight answers to Crown acquired land questions. The expropriation process is infinitely screwed up. There are no clear answers. There is no case law. I know of many people who disagree with my concerns above. I am simply raising obvious problems that must be evaluated before you drill.

The worst thing we can do as landmen and land lawyers is to pretend there are simple answers to complex questions. Personally, I blame the Saskatchewan Crown. 📖









- Mineral and Surface Leasing
- Right-of-Way Acquisitions
- Mineral Ownership/Title Curative
- Seismic Permitting
- Mapping/GIS Services
- Abstracts of Title



A FULL SERVICE LAND COMPANY SERVING NORTH AMERICA

Elexco Ltd.
Canada: 1.800.603.5263

www.elexco.com

Elexco Land Services, Inc.
New York: 1.866.999.5865
Michigan: 1.800.889.3574
Pennsylvania: 724.745.5600