

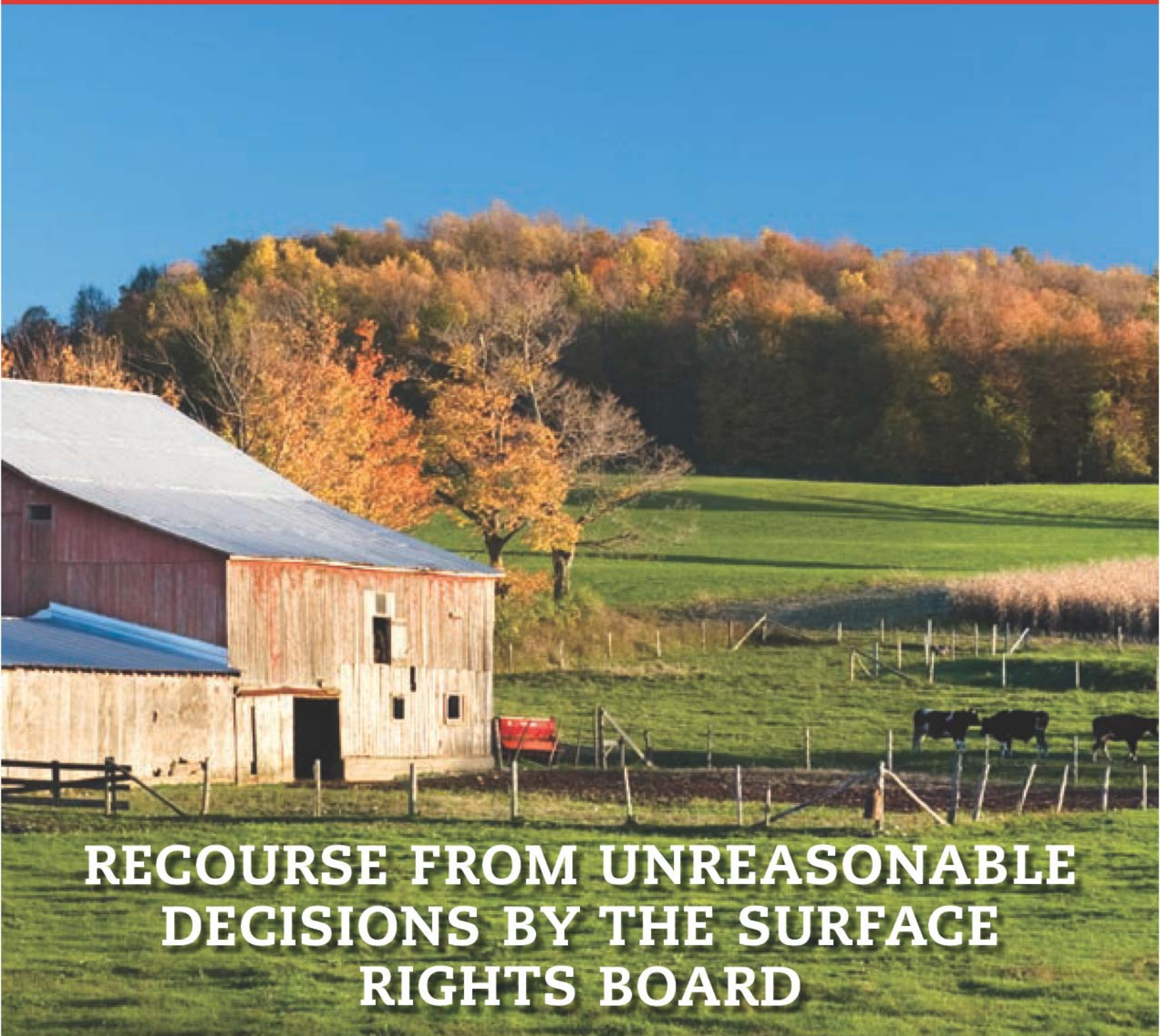
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RECOURSE FROM UNREASONABLE DECISIONS BY THE SURFACE RIGHTS BOARD

2007 CAPL Operating Procedure

Part V: Understanding the
Marketing Clause

It Can't Be Dead, We're Paying!

Compensatory Royalty Payments and
Continuation Under the 1991 CAPL Lease

***Imperial Oil Resources Ltd.
v. 826167 Alberta Inc.***

Recourse From Unreasonable Decisions
by the Surface Rights Board



It Can't Be Dead, We're Paying!

Compensatory Royalty Payments and Lease Continuation under the 1991 CAPL Lease

I WAS RECENTLY ASKED WHAT APPEARED TO BE A VERY SIMPLE QUESTION in relation to lease continuation beyond the primary term under the 1991 CAPL form of lease. The question was:

Is the payment of the compensatory royalty under subclause 8(d) (the offset well clause) sufficient to continue the lease beyond the primary term?

Intuitively, the answer would seem to be:

Yes of course it does. The lessee is making a payment to the lessor and so this payment continues the lease. Seems fair. Good enough. Let's move on.

However, as much as I like to give quick off-the-cuff answers to clients, I thought I had better try to work the question through the terms of the lease. At the end of the day, I could not find anything actually tying the payment of compensatory royalties to lease continuation. So my answer was:

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No. Seems crazy, but the payment of compensatory royalties does not continue the lease beyond its primary term.

Before you get mad, let me explain my answer.

Lease continuation beyond the primary term of the 1991 CAPL lease can occur in two ways. Firstly, the lease can be continued under the habendum. This is just a fancy word for the paragraph on the first page of the lease that states:

To have and enjoy the same for the term of ___ () years (herein called the "primary term") commencing on the date hereof and continuing so long thereafter as operations (as herein defined) are conducted upon the said lands, the pooled lands or the unitized lands, with no cessation, in the case of each cessation of operations, of more than 90 consecutive days. [emphasis mine]

So "operations" are what continue the lease under the habendum. Operations are defined in subclause 1(g) as follows:

- 1(g) "operations" means any of the following:
- (i) drilling, testing, completing, reworking ... or repairing a well or equipment on or in the said lands ...;
 - (ii) the production of any leased substance;
 - (iii) the recovery of any injected substances; or
 - (iv) any acts for or incidental to any of the foregoing.

I can find nothing in the definition of "operations" that makes the compensatory royalty payment an operation. In fact, the payment is compensation for not doing operations.

It is possible to "deem" certain actions to be operations. For example clause 9 (pooling and unitization) deems operations on pooled or unitized lands to be operations on the said lands. However, clause 8 contains no such deeming language with respect to the payment of compensatory royalties. The inclusion of deeming language in clause 9 makes it difficult to argue that deeming language should be "read into" (implied) into clause 8. I believe a court would look at the inclu-

sion of deeming language in one clause and not the other and decide that if CAPL meant to deem compensatory royalties to be operations, they should have written that into the lease.

There is language in clause 8(d) that some would argue deems production of leased substances through the compensatory royalty payment. Such deemed production would then be operations under clause 1(g)(ii). This wording appears in the middle of clause 8(d) in reference to the compensatory royalty payment as:

...a royalty which shall be proportionately equivalent on an acreage basis to such royalty as would have been payable to the Lessor if the leased substances produced from the offset well were actually being produced from a well on the said lands which commenced production on the last day of the said 6 month period...

This wording seems to me to be descriptive of how the royalty is calculated, not deeming language. If you want to see obvious deeming language, read clause 9(f).

The second way to continue a 1991 CAPL lease beyond the primary term is through clause 3 (suspended wells). Under this clause if a well is situated on the said lands, pooled lands or unitized lands and is "capable of producing the leases substances or any of them", the lease will be continued. If no such well exists then the lessee has no recourse to the suspended well clause. There is nothing in the clause about compensatory royalty payments.

At the end of the day, lessees must remember that even the 1991 CAPL lease is still at law only a *profit a prendres*, being another fancy word for the lessees exclusive right to win take and remove leased substances from the lessor's lands under the terms and conditions of the lease. The lessee did not buy the lands, nor did they pay for a long term exclusive lease, such as a 25 year primary term. For courts, the taking of this lesser estate or interest in land makes the freehold lease vulnerable to termination. If the lessee cannot prove (on a balance of probabilities) that the lease is valid and subsisting, then the lease is dead. Even if you are paying compensatory royalties.

Don't get me started about trying to get your money back. Long story. Short answer, don't hold your breath. ☹

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