

# NEWSLETTER

## The Freehold Owners Association (“FHOA”)

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## FHOA - A FIRST STEP TOWARD FAIRNESS

The Freehold Petroleum & Natural Gas Owners Association (“FHOA” or the “Freehold Owners Association”) was organized in late 1999 to:

- provide information and education to individual owners of subsurface oil and gas in Canada (“freehold owners” or “freeholders”);
- publicize freeholders’ concerns and promote fair treatment for all freehold owners; and
- provide a collective voice for freehold owners.

More than 1250 freeholders have

now joined FHOA.

### ANNUAL MEETING

The Annual Meeting of the Freehold Owners Association will be held in the Cascades Ball Room of the Holiday Inn, 6500 - 67<sup>th</sup> Street, Red Deer, Alberta at 1:30 p.m. on Saturday, January 20, 2001. A Notice of Meeting, Information Circular and Proxy are attached. All members who can do so, are urged to attend.

The directors of FHOA have determined that membership in the association will be on a calendar year basis beginning in 2001. If you joined FHOA before September 1, 2000, we have attached an invoice for membership fees in 2001.

If you cannot attend the Annual Meeting, please vote your Proxy by returning it to our offices together with your check for 2001 membership in the attached envelope. Please feel free to add any comments you feel are relevant.

### ACTIVITIES IN 2000

#### Information & Education:

Over the past year, FHOA has responded by telephone or letter to requests for information or advice from more than 400 freehold owners.

Due to the number of questions raised in membership application forms, we have still not responded to all queries. It is hoped that the information on FHOA’s web site, which we expect to have operational by the time of the Annual Meeting, will address many of the general questions raised by members. If your particular query has not been answered, please don’t hesitate to call our offices.

#### Fair Treatment:

During 2000, the Freehold Owners Association wrote to all Alberta MLAs expressing concern with what we consider to be excessive deductions from freehold royalties for the costs of gathering, transporting and processing natural gas, and seeking the support of all MLAs for FHOA’s efforts to achieve greater fairness for freehold owners in all aspects of our relationship with the oil and gas industry. The Association received positive responses from most senior cabinet ministers and from the Leader of the Opposition. Significantly however, only three other MLA’s (Ms. Carol Haley, Ms. Marlene Graham and Mr. Ken Nicol) responded.

In June, 2000, representatives of FHOA met with a member of the

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A Volunteer Organization Committed to Addressing the Concerns of Individual Owners of Freehold Minerals

Alberta Energy and Utilities Board (the EUB), the agency responsible for regulating all aspects of oil and gas operations in Alberta. The concerns of freeholders received a sympathetic hearing from the EUB member. EUB senior staff have subsequently provided valuable advice and assistance to the Association.

In July, 2000, *FHOA* met with representatives of the Canadian Association of Petroleum Producers (CAPP), an association representing companies that produce 95% of Canada's oil and gas. Senior CAPP officials were advised of the concerns of freeholders and expressed some interest in working jointly in an attempt to resolve these concerns.

Throughout 2000, *FHOA* continued its efforts to gain fair treatment for the more than 10,000 freeholders who own natural gas on 'split title' lands (see 2001 & Beyond - The Split Title Problem).

### Collective Voice:

**D**ue to the complexities of the legislative process, in many instances individual freehold owners may be totally unaware of changes, or proposed changes, in legislation impacting their property interests.

*FHOA* attempts to monitor proposed legislative or regulatory changes in order to speak out when these changes impact freehold owners.

In March of 2000, the Alberta Law Reform Commission sought comments from interested parties on the issue of Alberta class action

legislation. Class actions provide a procedural mechanism for individuals to join together to bring litigation in situations where they have a common issue. Class action legislation has existed in the United States for decades, and most other Canadians now have access to class actions. In *FHOA's* opinion, appropriately-structured Alberta class action legislation could significantly level the legal playing field between freehold owner-lessors and oil company-lessees by allowing freeholders, who could not otherwise afford to seek justice, to join together to litigate common issues such as gas royalty deductions.

In May of 2000, the Association submitted a brief to the Law Reform Commission setting forth *FHOA's* position on Alberta class action legislation. *FHOA* understands that the Commission's study has now been completed and that its recommendations respecting class action legislation will be submitted to the Alberta Government in early 2001.

To the same extent that legislative changes impact freeholders' property rights, court decisions in legal actions dealing with specific freehold lands can have a profound impact on all freehold owners.

For instance, in a 1998 Alberta Court of Queen's Bench decision (*Acanthus Resources Ltd. v. Cunningham*), the Court found that an oil company-lessee could deduct the costs of gathering, treating and storing oil where a freehold owner had reserved a gross royalty on the current market value of crude oil produced saved and marketed from

his lands.

The Alberta Government does not allow gathering, treating and storing deductions from Crown oil royalties and, prior to the *Acanthus* decision, it was not general oil and gas industry practice to make such deductions from freehold royalties.

The *Acanthus* decision opens the door to the same type of problem regarding deductions from freehold oil royalties as has plagued freeholder gas royalties for many years - the oil company-lessee will determine what is 'reasonable' in terms of oil gathering, treating and storing costs and the typical freehold owner-lessor will have no practical way of protecting himself from excessive deductions from royalties. The Court of Queen's Bench decision in *Acanthus*, which was not appealed to the Alberta Court of Appeal, may ultimately cost Canadian freehold owners many tens of millions of dollars in oil royalties.

One of the roles which *FHOA* sees for itself is intervening in legal actions and regulatory hearings which have the potential to impact freehold owners. Had the Association existed when *Acanthus* went to trial or when the Queen's Bench decision was rendered, an appeal might have proceeded.

At *FHOA's* Annual Meeting, members will be asked to vote on whether the Association should seek leave to intervene in another law suit which is currently proceeding through the legal system (*Anderson v. Amoco Canada Oil and Gas*). The final outcome of this litigation

will determine the ownership of hundreds of millions of dollars worth of production from wells drilled on split title lands.

## CURRENT ISSUES

### The CAPL 99 Lease:

The long-awaited CAPL 99 freehold lease agreement was released by the Canadian Association of Petroleum Landmen (the "CAPL") in November of 2000. In comparison to earlier CAPL lease forms, CAPL 99 improves the position of the freehold owner-lessor in two areas. Firstly, freeholders entering into CAPL 99 leases now have some specific protection from drainage through wells which diagonally offset their lands. Secondly, the shut-in well clause in CAPL 99 has been modified to potentially provide for improved compensation to freeholders in situations where the primary term of their lease is extended by a shut-in well.

On balance, *FHOA* considers CAPL 99 to be an improvement over CAPL 88 and CAPL 91, and recommends that its members use CAPL 99 as the **starting point** for negotiation in leasing their lands, and refuse to deal with land agents who insist on using either CAPL 91 or CAPL 88.

To be clear, ***FHOA* does not endorse the CAPL 99 lease form.**

#### Background:

Members interested in the historical development of the CAPL lease forms are referred to

the 1<sup>st</sup>, 2<sup>nd</sup> and 3<sup>rd</sup> editions of "The Oil and Gas Lease in Canada" by Mr. John B. Ballem, Q.C.

In the 1<sup>st</sup> edition of his text published in 1973, Mr. Ballem argued that the structure of the many different freehold lease agreements then in use in Canada exposed oil company-lessees to the risk of having their lease agreements terminated by the courts, unless the companies strictly adhered to the drilling provisions in their leases. Mr. Ballem proposed that a standard freehold lease form be developed which would reduce this risk and allow for oil and gas development "in a reasonable and equitable fashion".

In the 2<sup>nd</sup> edition of his text published in 1985, and in a series of subsequent talks, Mr. Ballem re-iterated his call for a standard oil and gas lease agreement "which would adequately protect the position of the oil company while at the same time treating the mineral owner fairly". In 1987, a joint committee of the CAPL and the Natural Resources Section of the Canadian Bar Association was formed to develop a standard lease form. This joint committee released the CAPL 88 lease form in 1988. An amended standard lease form known as the CAPL 91 was subsequently released by the joint committee.

In the 3<sup>rd</sup> edition of his text published in late 1999, Mr. Ballem states that "more than 95% of the leases currently being negotiated follow the CAPL form or, in some instances, computer-generated forms based on the CAPL lease."

There can be no doubt that the

structure of the CAPL 88, CAPL 91 and CAPL 99 lease agreements achieves Mr. Ballem's first stated goal of reducing the risk that the actions or inactions of an oil company-lessee will result in the unwanted termination of its freehold lease agreement by the courts. At a recent Insight Information conference, one member of the Natural Resources Section of the Canadian Bar noted that: "lessees have effectively put themselves in a position whereby they cannot lose their leases through lack of attention to detail and timing or through the failure to make timely payments." At this same conference, Mr. Ballem stated that: "When it comes to termination, the CAPL lease is pretty well bullet-proof.", and the Chairman of the CAPL and Canadian Bar Association committee responsible for drafting the CAPL 88, CAPL 91 and CAPL 99 leases stated that: "It seems that the efforts of the Committee over the past 12 years have been successful. In fact there has been almost no litigation over the modern lease form since its inception in 1988."

Clearly, success is in the eye of the beholder.

An agreement between two parties which is so oppressive that one party can breach it without fear that the other party can terminate the agreement through the courts, would not be expected to give rise to litigation. *FHOA* does not consider the absence of litigation involving CAPL leases to be a proper measure of the success of the CAPL and the Canadian Bar Association in achieving fairness.

With the support of a growing membership, FHOA intends to initiate discussions with all involved stakeholders in 2001 in an attempt to develop a standard freehold lease agreement which actually achieves the commendable goals set forth by Mr. Ballem - fairly balancing the interests of the oil company-lessee and the freehold owner-lessor, and allowing for oil and gas development in a reasonable and equitable fashion.

In the interim, the following comments may assist members in dealing with the CAPL 99.

#### Rentals & the Shut-In Well Clause:

The majority of FHOA's members have questioned the fairness of \$1 per acre per year 'delay rental payments' which have remained unchanged for 50 years, and the \$1 per acre per year 'shut-in well payments' which allow oil company-lessees to keep leases in force indefinitely with wells which may be dry holes for all intents and purposes except continuing the lease.

The CAPL 99 eliminates delay rental payments. According to Mr. Ballem, this has been done "*on the basis that the majority of leases are now likely to have very short primary terms, such as one or two years, so that there is no practical need for rental payments*".

More positively, the CAPL 99 replaces the \$1 per acre per annum shut-in well payment with potentially much larger annual payments. The shut-in well clause in the CAPL 99 provides that, if a well capable of production is drilled during the primary term of the lease but is not

produced for more than 720 hours in any year after the primary term, then the lessee must pay a sum equal to the total original lease payment divided by the number of years in the primary term.

For example, if you negotiate a CAPL 99 lease with a 2-year primary term and a bonus or lease payment of \$100 per acre, and if the oil company drills and shuts in a well on your lands, the lessee must pay you \$50 per acre in each year after the primary term that the well does not produce for at least 720 hours.

These changes make it essential for freehold owners to insist on short primary lease terms. In most circumstances, there is no justification for a primary term in excess of two years. In situations where an oil company insists on a longer primary term, freeholders may wish to amend the last phrase in Clause 3(b) of CAPL 99 to read: "*pay to the Lessor an amount equal to ~~that sum calculated by dividing the Lease Payment by the number of year(s) in the Primary Term (the "Shut-in Well Payment")~~*".

#### The Offset Well Clause:

Calls to FHOA's office indicate that most freeholders understand that the oil or gas which initially existed beneath one parcel of land may flow to, and be produced from, wells on other lands, and that ownership of oil and gas is determined by whose lands the oil or gas is produced from, not whose lands it originally existed under. These calls also indicate that many freeholders do not understand how to protect themselves from drainage.

Many freeholders assume that, once their lands have been leased, their oil company-lessee will protect them from drainage under the offset clause in their lease. The 'offset clause' typically requires the oil company-lessee to take some form of action within 6 months of an 'offset well' coming on production. The actions which typically must be taken by the oil company to satisfy its obligations under the lease include drilling on the freehold owner-lessor's lands, pooling or unitizing the lands, surrendering all or a portion of the lands, or paying compensatory royalties.

What many freeholders fail to recognize is that the offset clause in a typical freehold lease, like all other clauses which impose obligations on the oil company-lessee, must be read in conjunction with the 'default clause'. The typical default clause requires the freehold owner-lessor to provide the oil company-lessee with written notice describing any alleged breach of the company's obligations. The company then has a period of time (usually 30 days) to begin to remedy the breach or, in the case of CAPL lease forms, to commence a legal action to determine whether a breach has occurred.

After your mineral rights have been leased, you should regularly monitor lands adjacent to your lands for production from offset wells. Not all oil companies are competent or vigilant and, in circumstances where your oil company-lessee has an interest in lands adjacent to yours, it may be economically advantageous for your oil company-lessee to drain your lands. If your oil company-lessee does not comply with its

offset obligations, you should review the default clause in your lease with a view to either filing a notice of default or seeking competent legal counsel.

In most freehold lease agreements, including CAPL 88 and CAPL 91, 'offset wells' are defined as wells drilled on spacing units laterally adjoining the freehold owner-lessors' lands (ie. immediately north, south, east or west). CAPL 99 extends the freehold owner-lessor's protection from drainage to wells drilled on diagonally offsetting spacing units by defining an offset well as "*any well drilled subsequent to the effective date hereof and producing Leased Substances from any Spacing Unit laterally or diagonally adjoining the lands ...*".

Although extending drainage protection to wells producing from diagonally offsetting spacing units is a positive step for freeholders, the reference to "*drilled subsequent to the effective date hereof*" is not. What this means is that wells that have been drilled on laterally or diagonally offsetting spacing units before the date of the lease are not offset wells, even if these wells were not producing at the time the lease was signed. Instead of the offset clause providing protection to you, an unscrupulous oil company-lessee may actually rely upon this offset clause wording to drain your mineral rights from a pre-existing well laterally or diagonally offsetting your lands.

Prior to leasing your mineral rights under a CAPL 99 lease agreement, you should determine whether there are any un-abandoned wells laterally

or diagonally offsetting your lands. If such wells exist, you may wish to delete the words "*drilled subsequent to the effective date hereof and*" in Clause 1(h) of the lease, or include the legal descriptions of any such pre-existing wells in the definition of offset well.

Freeholders who do not live on the lands overlying their mineral rights may find it difficult to monitor drilling and production activities. One of the issues to be voted on by members at the Annual Meeting is whether *FHOA* should take steps in 2001 to make some of the necessary information available to members on a non-profit basis (see 2001 and beyond).

#### Deep Rights Reversion:

In 1983, the Government of Alberta retroactively amended the terms of Crown leases so that all geological zones below the base of the deepest zone proven productive reverted to the Crown. Although, at the time, some oil and gas companies complained that the government had violated the sanctity of contract, it is now generally accepted that the industry as a whole has benefited from the Government's actions which freed up Crown deep rights for exploration and development. Other Provincial Governments have since followed Alberta's lead.

In the 3rd edition of "The Oil and Gas Lease in Canada", published in late 1999, Mr. John Ballem compliments the joint committee of the CAPL and the Canadian Bar Association for its "*commendable effort to level the playing field between the lessor and the lessee*".

Mr. Ballem's text references the deep rights reversion clause in the CAPL 99 lease. In fact, no such clause exists in the version of CAPL 99 released in November of 2000.

In the Freehold Owner's Association's view, there is no justification for the absence of a deep rights reversion clause in CAPL 99.

If you are contemplating leasing your mineral rights under a CAPL 99 lease agreement, you may wish to add the following clause to the agreement: "*PROVIDED that if, at the expiration of the Primary Term, the Lands, the Pooled Lands or the Unitized Lands are capable of Commercial Production, the Lessee shall surrender all geological formations within the Lands which lie below the base of the deepest geological formation which is capable of Commercial Production and, in the event of the Lessee having registered in a Land Titles Office this lease or any caveat or other document claiming an interest under this lease, the Lessee shall forthwith take such steps as may be necessary to amend said registered documents to limit the interest claimed to those parts of this lease that continue in force.*"

#### Other CAPL 99 Clauses:

*FHOA* recommends that members consider making the same changes to the "Shut-In Well" clause, the "Pooling and Unitization" clause, the "Default" clause and the "Entire Agreement" clause as were recommended with respect to the CAPL 91 in our last newsletter.

These recommended changes and further comments on CAPL leases will be posted on the Association's web site.

### Royalty Trusts:

During the late 1940's and the 1950's, thousands of Gross Royalty Trust Agreements (GRT's) were entered into by western Canadian freehold owners. The subject matter of these trust agreements was the then standard 12 1/2% royalty that freeholders were able to negotiate with oil companies. Freehold owners entering into a GRT would effectively convert their 12 1/2% royalty into royalty trust certificates or units and then sell, trade or gift the units, as the freeholder saw fit. The oil company-lessee would then pay the entire 12 1/2% royalty to the trust company named in the GRT, and the freehold owner would receive royalties from the trust company based on however many units in the GRT the freeholder had retained. The balance of the 12 1/2% royalty would be paid to the other holders of units or certificates in the GRT.

Prudential Trust was the trustee named in most GRT's, but other trust companies such as First City Trust and Security Trust were also involved. A number of different forms of GRT agreement were used by these trust companies.

Since the mid-1980's, the validity of GRT's has been questioned in a number of legal actions in the Alberta courts. Court decisions of note include Guaranty Trust Company of Canada v.

Hetherington, Scurry-Rainbow Oil Ltd. v. Galloway Estate, Scurry-Rainbow Oil Ltd. v. Kasha et al. and Montreal Trust Co. of Canada v. Astl.

In the 1987 Alberta Court of Queen's Bench Hetherington decision, the Court considered one of the more common forms of GRT known as the 'PTC-1', and found that the property interest transferred from the freehold owner to the trust company was not an interest in land. This meant that the GRT could not be enforced against a new owner of the freehold land. The Queen's Bench decision in Hetherington placed the validity of all forms of GRT in question, and the trust companies administering the GRT's paid all of the royalties in dispute into court, pending final judicial determination of who was entitled to the royalties.

The Queen's Bench decision in Hetherington was appealed and, in 1989, the Alberta Court of Appeal ruled that where the original petroleum and natural gas lease referred to in a PTC-1 GRT expired under its own terms, the GRT likewise expired and the freehold owner was not bound by the GRT. The Appeal Court did not find it necessary in Hetherington to decide whether the PTC-1 GRT created an interest in land.

Subsequently, in Galloway Estate, test cases involving both PTC-1 and other forms of GRT's in differing factual circumstances were considered by the courts. In these test cases and in Kasha, the Alberta Court of Appeal upheld Court of Queen's Bench rulings in which the GRT's in question were found to have created

valid interests in land, binding upon new mineral owners.

Many questions respecting both the validity of GRT's and their administration have been raised by members. At the present time, there remains some uncertainty as to the validity of any given GRT and its units or certificates.

With respect to PTC-1 GRT's, an appeal of the Court of Queen's Bench decision in Astl is scheduled to be heard in the Alberta Court of Appeal in March, 2001. This appeal will decide the disposition of approximately \$2 million which continues to be held in court because no action has been taken by the involved freehold owner to either collapse or affirm the underlying PTC-1 GRT.

*FHOA* recommends that all members whose lands are subject to a GRT obtain a copy of their GRT and, if it is a PTC-1 which references an expired lease, seek competent professional advice.

## 2001 & BEYOND

### Information & Education:

One of the difficulties faced by freeholders in protecting their property interests is access to technical information. In 2001, *FHOA* proposes to subscribe to an Alberta well and land information database so as to provide members with information specific to their lands for a modest fee upon the member's request. It is proposed that a member would be provided with a map showing wells on the member's lands and immediately offsetting lands, together with

historical production information for all such wells and any recent Crown land sale information. A fee of \$50 per request is contemplated as being necessary to cover database and administrative costs.

The information provided will not be interpretative. The intention is to provide members with enough basic information at a reasonable cost for members to monitor their property, identify possible problems, and retain technical or legal experts for interpretive purposes, if necessary. Information will not be provided to non-members, or to members for any other purpose than monitoring their own property.

### **The Split Title Problem: Background:**

The title to petroleum and natural gas is split on approximately one million acres of freehold land in Alberta. These 'split-title' lands arose during the 1906 - 1912 period when natural gas was considered to be a dangerous nuisance and the Canadian Pacific Railway Company sold farm-sized parcels of land to homesteaders reserving unto itself only all coal and petroleum "*which may be found to exist*" within, upon or under the lands.

The CPR initially ignored the problems associated with its failure to retain title to natural gas within, upon or under split title lands. The CPR took the position that petroleum included natural gas and, in leases of its petroleum rights to oil companies, demanded and received a royalty on all gas produced from all wells on split title land.

In 1949, Mr. Michael Borys, an owner of split title natural gas in the Leduc Field, challenged the CPR's position. In Borys v. CPR and Imperial Oil Limited, Borys claimed that he was the owner of any gas produced at surface from a well on his split title lands. In 1951, the Alberta Supreme Court agreed with Borys. The Court ruled that Borys was the owner of all gas within his land and that the distinction between petroleum and natural gas was the phase state of the hydrocarbons as they were produced from time to time under standard surface conditions. The court also granted Borys a permanent injunction preventing Imperial from interfering with his gas.

The hydrocarbon compounds which are the principle constituents of petroleum and natural gas are almost all soluble in each other, and the degree of their solubility is determined by temperature and pressure. In the subsurface, hydrocarbons are found trapped in porous geological strata under temperatures and pressures significantly greater than at surface. Liquid hydrocarbons in the subsurface invariably contain gaseous hydrocarbons in solution. When these liquids are lifted to surface through a well in the production process, the confining pressure is reduced and dissolved gas breaks out of solution. As a result, all oil wells produce some gas.

Because markets for natural gas in the early 1950's were very limited and because all oil wells produce some gas, the practical implications of the Alberta Supreme Court ruling in Borys were immense. All oil wells on split-title lands would have to be shut-in and further development of

southern Alberta in the area of split-title mineral rights would cease pending the development of what, at that time, were unforeseen gas markets.

In 1952, the Alberta Supreme Court Appellate Division reversed the Borys trial court decision, in part. The Appellate Division ruled that what had been reserved by the CPR was petroleum in the earth not petroleum at surface, that the CPR's reservation of petroleum included "*gas in solution in the liquid as it exists in the earth*", and that the CPR and Imperial had the right to work their petroleum even if this resulted in the wastage of Borys' gas, provided that operations were conducted in accordance with accepted industry practice and relevant statutory regulations.

The Appellate Division decision in Borys was appealed to the Judicial Committee of the Privy Council, then the highest court of appeal in the Commonwealth. According to the Privy Council, the Appellate Division had found that the distinction between petroleum and natural gas was to be based on: "*the condition of the substance as it emerges from time to time from the reservoir*". In its 1953 decision, the Privy Council found that the Appellate Division's decision on Borys was "*right in all respects*". The CPR continued to prescribe and enforce petroleum lease agreements in which it demanded a royalty on hydrocarbons owned by the owners of natural gas on split title lands.

During the 1990's, 22 legal actions were initiated by owners of natural gas alleging, amongst other things,

that they had been deprived of their rightful share of royalties on production from split title lands and that these royalties had been paid to the CPR and its successor PanCanadian Petroleum Limited. In 1997, all of these actions were effectively stayed when the Chief Justice of the Court of Queen's Bench of Alberta ordered that a trial be held to determine, as a preliminary issue of law, the ownership of hydrocarbons produced from a well on split title lands.

### The Ownership Trial

A 6 1/2 day trial referred to as Anderson v. Amoco Canada Oil and Gas was held in December of 1997. At trial there was no dispute that the Privy Council decision in Borys was applicable and binding authority. According to the trial judge, the case turned "*largely on an analysis and interpretation of Borys.*"

According to the CPR, "*an array of the world's greatest living scientists*" testified in Borys. These eminent scientists advised the Borys courts that the Leduc D-3 pool beneath Borys lands was an oil pool with a gas cap, and that "*if the condition specified (to distinguish petroleum from natural gas) was that in the reservoir as it occurred naturally before disturbed by man*" ... "*in reservoirs containing a free gas cap with oil below, difficulties of separating ownership between the gas that was originally free and that was originally in solution, would be physically and practically insurmountable*".

The fundamental principles of oil and gas behaviour which create these insurmountable difficulties have not changed in the 50 years since Borys. In Anderson however, lawyers for the CPR, PanCanadian, Imperial and the other oil company-defendants argued that Borys was authority for the very proposition of law that the CPR and Imperial had so convincingly argued against during the Borys trial - that petroleum should be distinguished from natural gas on split title lands based on the phase condition of the substances in the ground prior to human disturbance.

Counsel for the freehold owner-plaintiffs argued that in Borys the Privy Council had clearly stated that petroleum was to be distinguished from natural gas based on "*the condition of the substance as it emerges from time to time from the reservoir*", and that the failure of oil companies to pay royalties to individual freehold owners of natural gas on this basis was the result of the improper contractual demands of the CPR and its successor PanCanadian, not a proper interpretation of the law.

In support of ownership determination prior to human disturbance on split title lands, the oil company-defendants called a former Chair of the EUB who testified that the EUB had historically operated on this premise. The trial judge relied on this testimony in respect of fairness and settled expectation arguments.

Settled expectations arise when important decisions are made based on judicial rulings. When this happens, courts are reluctant to overturn a decision which has resulted in the settled expectation.

Subsequent to the Anderson trial, in response to a request made to the EUB under the Freedom of Information and Protection of Privacy Act (the FOIP Act), the EUB was unable to produce a single document to indicate that the EUB had reviewed the Borys decision in formulating the premise under which it purportedly operated. If the EUB had a settled expectation about the ownership of petroleum and natural gas on split title lands, this settled expectation was apparently not based on the Borys decision. The current EUB Chair has declined to comment upon whether the EUB does, in fact, operate on the premise attributed to it.

Subsurface pools containing petroleum frequently extend beneath more than one parcel of land. Producing petroleum or natural gas from a well in one part of a subsurface pool usually causes the pool pressure to decline and gas to evolve from petroleum throughout the pool. As a result, the petroleum which "may be found to exist" beneath a parcel of land when a well is drilled on that land and hydrocarbons are recovered from the well may not be the same petroleum as existed beneath the land prior to human disturbance of the pool. The petroleum which initially existed may have been replaced, in whole or in part, by gas which has evolved from petroleum due to pool pressure decline. This type of gas is known as 'evolved gas'.

According to the trial judge in Anderson, the ownership of evolved gas was the most critical issue in the litigation.

In her July, 1998 decision, the trial judge found that the freehold owner-plaintiffs were wrong to have relied upon the Privy Council's summary of the Appellate Division decision which it upheld. According to her Ladyship, this summary was "troublesome" ,... "inconsistent" ,... "inaccurate" , "respectfully wrong" and not binding upon her.

The trial judge found that PanCanadian, as owner of all petroleum, owned all of the petroleum which existed beneath split title lands prior to human disturbance, including evolved gas.

But the CPR did not reserve all petroleum which 'existed' beneath split title lands prior to human disturbance. The CPR drafted the transfer agreements which gave rise to split title lands and in these transfer agreements it reserved all petroleum "which may be found to exist" beneath these lands.

#### The Land Titles Issue:

In reviewing the trial judge's decision in Anderson, it became apparent to *FHOA* that the Alberta Registrar of Land Titles, whose job it is to transcribe the exact wording in a transfer agreement unto a certificate of title, had omitted the 'which may be found to exist' wording in all titles issued in respect of split title lands in Alberta.

Absent the Registrar's omission of the 'which may be found to exist' wording on title, it is difficult to see how the trial judge could have arrived at the conclusion that PanCanadian owned all petroleum as it 'existed' prior to human

disturbance. A reservation of all petroleum 'which may be found to exist' is clearly contingent and prospective, not retrospective.

*FHOA* has asked the Registrar of Land Titles to correct its omissions or refer these matters to a judge. The Registrar has declined to do so and takes the position that if it made an error, which it denies, the limitation period for freehold owners of natural gas to make claims against the Assurance Fund has expired and it has no liability. In the opinion of the Freehold Owners Association, the liability or potential liability of the Registrar to individual owners of natural gas is largely irrelevant. In *FHOA's* view, what is relevant is that the Registrar's omission and refusal to take action in this matter may result in a miscarriage of justice.

The 1954 decision of the Supreme Court in CPR and Imperial Oil Ltd. v. Turta and Sereda is generally recognized as the leading Canadian authority on the Registrar's duties and obligations under the Land Titles Act. In Turta, a Registrar's error in respect of a Certificate of Title to split title land resulted in the CPR and Imperial Oil being deprived of petroleum with an estimated value of \$5,000,000.

All nine members of the Supreme Court were critical of the administrative practices of the Alberta Land Titles Office. Mr. Justice Cartwright stated "That land was, and should have been described in the certificate as, the N.W. quarter of Section 17, excepting and reserving unto the Canadian Pacific Railway Company all coal and petroleum

*which may be found to exist within upon or under the said land.*" Chief Justice Rinfret described the actions of the Registrar as, not just an error, but "stupidity of the most glaring character."

*FHOA* understands that, following the Turta decision, then Alberta Premier Ernest Manning ordered the Land Titles Office to review every mineral title file in the Province for errors, and approximately 60,000 mineral files were created.

In March of 1999, *FHOA* sought access under the FOIP Act to all documents in the possession of Alberta Government Services and Alberta Justice having to do with the authority under which the 'which may be found to exist' wording on titles to split title lands in Alberta had been omitted by the Registrar of Land Titles.

In November of 2000, following an investigation into the response to *FHOA's* request, the FOIP Commissioner ruled that the documents sought by *FHOA* were records made from information in a Land Titles Office and were exempt from access under the FOIP Act.

In the words of the Chief Justice of the Supreme Court in Turta: "I would venture to say that he (the Registrar) is the only man on earth who is not held responsible under the law for his errors. Indeed, he is invited to make errors, since he is told by the law that that will entail no responsibility on his part. He is invited to be negligent."

#### The Costs Issue:

In a December, 1998 decision on costs, the trial judge in Anderson ordered the freehold owner-plaintiffs to pay the oil company-defendants approximately \$600,000 in costs forthwith (immediately) and in any event of the cause (irrespective of who wins the legal actions underlying the trial of the preliminary issue).

In recent years, Canadians have grown increasingly cynical concerning the self-serving actions of our politicians. To date, this public cynicism has not been extended to the judicial system. Canadians recognize that judges and juries are only human and can make mistakes. The wrongful murder convictions of David Milgaard in Saskatchewan and Guy Morin in Ontario abundantly demonstrate the potential for grievous errors to be made in the administration of justice. But these errors were ultimately corrected, reinforcing Canadians' deeply held faith in the integrity of their legal system. This faith is based, at least in part, on one of the fundamental safeguards in our legal system - the right to appeal an alleged error by a trial judge to a court of appeal.

One would have to be incredibly naive not to expect that the effect of ordering citizens of ordinary financial means to pay \$600,000 in costs to the same oil companies the citizens are suing, after a trial of a preliminary issue of law and before the trials of their law suits have even begun, would be to put an end to both the underlying law suits and the appeal of the trial judge's decision in the preliminary issue.

The trial judge was not sympathetic to the "*hint that ordering costs to be payable forthwith might end the litigation because of the plaintiffs' limited financial resources*". According to her Ladyship, the freehold owner-plaintiffs "*appear not to be paying the bills for this litigation*".

Why should individuals who cannot afford to advance their legal claims except under contingency fee agreements with lawyers and technical experts be treated any differently by the courts than individuals or corporations who can afford to pay on a fee for service basis?

PanCanadian maintains one of the largest technical staffs of any oil company in Calgary. PanCanadian's staff presumably has a thorough understanding of the behaviour of subsurface hydrocarbons during the production process. Nevertheless, PanCanadian found it necessary to expend \$83,000 on outside technical experts for a 6½ day trial. How many individual freehold owners can afford such expenditures for technical expertise?

In her cost decision, the trial judge noted the "*high profile clients, critical industry issues and plethora of senior lawyers*" who appeared before her. According to her Ladyship, had she ruled in favour of the individual freehold owner-plaintiffs, her ruling would have had "*serious implications*" to the "*oil and gas industry, its regulators, investors and bankers*". There was no evidence whatsoever before her Ladyship to this effect. The evidence before the trial judge was that oil

companies typically lease petroleum from PanCanadian and natural gas from individual freehold owners. As such, had the trial judge ruled in favour of the individual freehold owners of natural gas, her ruling would have had no material impact on the industry, its regulators, investors or bankers. The only material impact of such a ruling would have been to re-allocate royalties from PanCanadian to individual freehold owners of natural gas. Re-allocations of royalties and revenues are a normal part of the oil and gas business, and PanCanadian is a 10 billion dollar corporation that can presumably afford to satisfy an adverse judgment.

The ownership decision of the trial judge in Anderson impacts all of the more than 10,000 freeholders who own split title natural gas in Alberta and an unknown number of natural gas owners in other provinces. According to counsel for one of the oil company-defendants, hundreds of millions of dollars worth of production were involved. Her Ladyship's cost decision impacts every freehold owner who cannot afford the high cost of oil and gas litigation.

It is anticipated that an appeal of the trial judge's decisions will be heard by the Alberta Court of Appeal in the 2<sup>nd</sup> quarter of 2001. In the event that leave to appeal to the Supreme Court of Canada is sought and granted in respect of the Court of Appeal decision, *FHOA* proposes to seek leave to intervene before the Supreme Court. All members are urged to exercise their right to vote on this matter.

On behalf of the board of directors

Richard B. Riggins,  
President