

NEWSLETTER

The Freehold Owners Association (“FHOA”)

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INITIAL MEMBERSHIP DRIVE SUCCESSFUL

More than 1100 freehold owners have now joined the Freehold Petroleum & Natural Gas Owners Association (“the Freehold Owners Association” or “FHOA”).

FHOA wishes to express its thanks to the Alberta Department of Resource Development and, in particular, to Mr. David Coombs and the Honourable Steve West, Minister, for their assistance in establishing the Association’s initial membership.

ORGANIZATION

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MEETING

One hundred and sixty people attended the Association’s organizational meeting held in Calgary on October 20, 1999. At this meeting, Mr. Richard Anderson, Mrs. Gloria DeLisle, Mr. Keith Luft and Mr. Richard Riggins were elected as directors of the Association for the 1999 - 2000 year. Mr. Riggins, who took the initiative in forming FHOA, was also elected as President.

Members wishing to review the minutes of the organization meeting are asked to call the Association’s office for a copy.

MEETING QUESTIONNAIRES

Members who attended FHOA’s organizational meeting were provided with questionnaires in which they were asked to rank in importance (on a scale of 1 - 10) certain items which had previously been identified as issues of concern by members. Considered most important were:

- explanations of the various clauses found in freehold leases (average importance 9.4);
- an independent body with the power to review and arbitrate disputes between freehold owners and oil company/lessees (9.2 on average); and

- clarification of the meaning of the term ‘current market value at the well head’ found in most freehold leases and used by oil companies in calculating gas royalties (9.0 on average).

Significantly, none of the 21 items on the ‘wish list’ provided in the questionnaire scored below 7.0 on average.

MEMBERSHIP APPLICATIONS

In the Association’s membership application forms, prospective members were asked if they had a specific area of concern such as fair annual rent or fair royalty rate.

Forty-eight percent of members were concerned with fair royalty rates. This concern appeared to be most prevalent amongst members who are bound by old lease agreements with 12 1/2% royalty rates.

Forty-two percent of members were concerned with the fairness of rental rates. Many members pointed out that the standard \$1 per acre rental rate has not changed in 50 years.

Fifty percent of members expressed other concerns. Many members took the trouble to write detailed letters setting forth their concerns. Others (16%) framed

their concerns as requests for information, advice and help. For example:

- *“What is a fair processing and transportation fee? Do freeholders pay (the) same % fee as government?”*
- *“How can we be overcharged for processing costs - aren't there regulations to hold oil companies accountable?”*
- *“My royalty payments are never paid on time. What can I do?”*
- *“Why won't my lessee provide me with an explanation in simple language of how they arrive at the amount we are paid?”*
- *“Should there be a limit on how long a shut-in gas well passed from company to company can hold a lease?”*
- *“How long can a lease be held after production ceases?”*
- *“Why can't lease agreements be written in plain language easily understood by owners?”*

Overall, 14% of members specifically mentioned their concern with the deductions levied by their oil company/lessees in arriving at the 'market value' of their gas. Most members did not understand how the gas gathering, transporting and processing fees deducted from their royalties were calculated, many questioned the fairness of these calculations, and others wondered who was monitoring the deductions.

Thirteen percent of members were concerned with their royalty statements and payments. Members' complaints ranged from

late or non-payment of royalties, to statements which lacked detail or were indecipherable. Many members expressed frustration because their lease agreements clearly required royalty payments to be made on or before a particular date each month, but there seemed to be no way of forcing their oil company/lessees to honour this obligation.

The fundamental nature of the lease agreement they had signed, or might be asked to sign in the future, was a concern to 12% of members. Many expressed the view that freehold lease forms drafted by oil company lawyers for the benefit of oil company/lessees without input from freehold owners were unfair. A number of members specifically objected to the CAPL 88 and CAPL 91 freehold lease agreements. These lease forms, developed by the Canadian Association of Petroleum Landmen (the “CAPL”) and the Canadian Bar Association, have been used by the vast majority of oil companies in western Canada for the past decade.

Members were particularly concerned with the 'Suspended Wells' clause in CAPL leases. This clause allows an oil company/lessee that has drilled and completed an uneconomic well on a freehold owner's lands to hold his or her mineral rights indefinitely for speculative purposes merely by paying the freeholder \$1 per leased acre each year.

Other issues which were of concern to a significant number of members included:

- **Offsetting Production:** Members who did not live on the land were

concerned with how to monitor drilling and production activity offsetting their lands. Offsetting horizontal wells were a concern to other members because they did not know how to determine the subsurface location of an horizontal well, how to determine whether the well was draining their oil or gas, or what to do about it if it was;

- **Deep Rights:** Members were concerned with the fact that under CAPL leases (and most other freehold lease forms historically used in Alberta) an oil company/lessee drilling and completing a shallow well for production earns all geological zones from the surface to the center of the earth. Members questioned the fairness of this because an oil company drilling on Crown lands in Alberta only earns to the base of the deepest geological zone proven capable of production.
- **Assignment:** Members wondered whether it was fair for the assignment clause in CAPL leases and most other freehold lease agreements to allow the oil company to transfer its interest to more than one party, but to prohibit the freeholder from doing the same;
- **Caveats:** Members were concerned with maintaining a clear title to their mineral rights and wondered why CAPL lease agreements did not contain a clause requiring the oil company/lessee to remove its caveat from their title after the company's lease has expired;

- **Well and Land Sale Information:** Many members wondered how information regarding the status of wells on or in the vicinity of their lands and the production from these wells could be acquired. Members also wondered where they could obtain the prices that had been paid for Crown lands offsetting their mineral rights. A large number of members suggested that *FHOA* provide this information to members on a non-profit basis;
- **Deductions from Oil Royalties:** Members who had received oil

royalties without deductions for years questioned why their oil company/lessees had recently begun to deduct oil processing charges;

- **Royalty Trusts:** Some members were aware of recent Alberta litigation respecting the validity of royalty trust agreements, but were unsure of the impact of this litigation on their property rights. Other members questioned the fairness of fees charged by trustees to administer royalty trust agreements;
- **Estate Planning:** How best to pass their mineral rights on to succeeding generations was a concern to many members; and
- **Professional Help:** A number of members asked the Association to provide them with names of competent technical, accounting and legal professionals who could assist them for a fee in negotiating lease agreements, evaluating their oil and gas properties, planning

their estates, and protecting their property rights.

SUMMARY OF MEMBER CONCERNS

The vast majority of members' questions and concerns relate directly to freehold lease agreements.

Members owning producing oil or gas rights and legally bound by existing lease agreements are primarily concerned with fully understanding the terms and conditions in their leases, knowing how to monitor the performance of the oil companies that have leased their lands, and having someone to turn to in situations where their oil company/lessee fails to honour its obligations. Members whose mineral rights are non-producing share these concerns but are also concerned with modifying future freehold lease forms to more fairly

balance the rights of freehold owners and oil company/lessees.

FHOA'S ROLE Pro-Active Voice

As set forth in the information package provided to prospective members last fall, the principle objective of the Association is to provide a common voice for freehold owners in matters of broad general concern to them. The large membership which the Association has achieved in less than 4 months of active operations clearly demonstrates that freehold owners are deeply concerned with protecting their property rights and recognize the need for an association such as *FHOA*. Many members specifically commented on the need for a 'watchdog' and a 'voice'.

The results of a 1999 Angus Reid poll conducted for the Petroleum Communication Foundation ("PCF") illustrate the

problem. The poll, which was commissioned by PCF to determine how Albertans view the oil and gas industry, found that 94% of Albertans hold a neutral to favourable view of the oil and gas industry. The concerns of the few Albertans who hold an unfavourable view of the industry included the effect of industry operations on the environmental, pollution, land reclamation, safety and health issues, depleting resources, increasing prices, profiteering, gas emissions, and employment issues. The Angus Reid statistics imply that of the 1200 Albertans surveyed, not a single one was concerned with the industry's treatment of freehold owners.

Clearly, increasing public awareness of the plight of freehold owners is a priority for the Association. Concurrently, *FHOA* must raise its voice as an advocate for freeholders in regulatory and other matters which impact us all.

Education and Information

Based on the hundreds of telephone calls which *FHOA* has received from freeholders in the past few months, on the comments of members attending the organization meeting, and on the responses of members in membership application forms and questionnaires, it is clear that members also want the Association to provide them with information and education.

FHOA'S FUTURE DIRECTION

As a volunteer organization currently funded solely by \$25 membership fees, *FHOA* has neither the manpower nor the financial resources of the many oil and gas industry associations that so successfully communicate the industry's point of view. If the Association is to succeed in its 3-fold task of publicizing freehold owner concerns, acting as an advocate for freeholders, and providing information and education to our members, we must wisely use our limited resources.

Although *FHOA* has responded to all of the telephone queries we have received and has called many of the members who raised questions in their membership application forms, the telephone is not the most efficient way to answer general questions and a large number of members' questions remain unanswered.

A newsletter is clearly necessary to make members aware of *FHOA's* activities and to provide information and education. Several members have professional legal experience in estate planning and royalty trusts and have indicated a willingness to write an article on these subjects for inclusion in the Association's next newsletter. But a newsletter alone cannot hope to address the many questions and concerns that have been raised.

Members have suggested that the Association arrange seminars to provide freehold owners with information on freehold lease agreements and monitoring oil and

gas activity. Others have suggested that the Association publish brochures dealing with the various clauses in freehold lease agreements. Still others have suggested that future meetings be held in centres other than Calgary. These are all good suggestions and will be pursued to the extent that *FHOA's* finances allow.

A more cost-effective and efficient way of publicizing freehold owners' concerns and informing and educating members is provided by the Internet.

Internet Web Site

Ninety-nine percent of the Association's members are residents of North America. The majority of North Americans now have a home computer with access to the Internet, and the percentage is growing rapidly. Furthermore, 86% of *FHOA's* members live in Alberta. Under a program funded jointly by Alberta Community Development and Industry Canada, computers with Internet access have been installed in 270 of the 300 public libraries in rural Alberta. Trained librarians are available to provide assistance with the use of this free service in both rural libraries and in the libraries of all major centers in Alberta.

The Association is currently drafting information for incorporation into its web site. A member who has experience in web design has volunteered to help. We anticipate that the Association's web site will be operational within the next

several months at www.FHOA.ca.

IMMEDIATE CONCERNS

CAPL 99/CAPL 91

Members who attended the Association's Oct. 20, 1999 organizational meeting will recollect that there was considerable discussion regarding the CAPL 99 freehold lease agreement - a replacement for the CAPL 91 lease form which many members find so objectionable. The Chairman of the joint committee of the CAPL and the Natural Resource Section of the Canadian Bar responsible for drafting both CAPL 91 and CAPL 99 attended the organizational meeting and advised those present that his committee would not provide FHOA with a copy of CAPL 99 in draft form as had been requested, but would provide a copy of the lease in its final form within several weeks, after it had been approved by all other stakeholders.

Four months later, FHOA has not received a copy of CAPL 99. The Association has delayed this newsletter in order to provide members with comments on CAPL 99, but cannot delay further because members continue to be approached to enter into CAPL 91 leases.

If you are asked to sign a CAPL 91 lease agreement, you may wish to consider making the following simple modifications to protect yourself:

- Clauses 1(f) and 8: strike out "*laterally*" and substitute "*contiguously*" in the 1st line of

1(f), the 2nd and 3rd lines of 8, the 2nd line of 8(a), the 1st line of 8(b), the 2nd line of 8(c), and the 4th line of 8(d) - this may protect you from diagonal drainage;

- Clause 3: in the 2nd line strike out "*producing*" and substitute "*commercial production of*" - this may prevent indefinite continuation of your lease for speculative purposes;
- Clause 9: strike out entirely - pooling and unitization may be in your best interest but you should retain the right to review and approve any pooling or unitization proposal;
- Clause 15(b): in the last 3 lines strike out "*nor shall it terminate if the Lessee within 30 days of such final determination has remedied or commenced to remedy the breach or breaches, and having so commenced to remedy the breach or breaches thereafter diligently continues to remedy the same*" - if you have to go to court to force your oil company/lessee to perform its obligations, why should your lessee get a 2nd chance?
- Clause 22: in the 1st and 2nd line strike out the 1st sentence "*The terms of this Lease constitute the entire agreement between the parties, and no implied covenant or liability of any kind is created or shall arise by reason hereof or anything contained herein.*" - there is no reason for you to acknowledge the absence of implied covenants in your lease.

More detailed comments on CAPL 91 will be provided on the Association's web site.

Improper Gas Royalty Deductions

Many members have sought the Association's advice regarding letters they have received from a private company advising them that they have been overcharged with improper gas royalty deductions, in some cases in the millions of dollars, and offering to recover past unpaid royalties on a contingency fee basis. These letters state that under terms of the new Alberta Limitations Act "*once you have been made aware of breaches to your Lease, you have only two years from that date to take action, or your claim will die*", and that the limitation period may have started to run as a result of the freehold owner's receipt of the letter.

The Freehold Owners Association has no relationship whatsoever with the private company which is offering the above services to freeholders.

In FHOA's view, the gas royalty deduction or 'market value' issue being addressed by the private company is an issue which impacts many freeholders and needs to be addressed, but the company's approach to freehold owners raises concerns regarding the new Limitations Act.

In 1999, the Association wrote to Justice Minister Hancock and all government MLAs objecting to the impact of the new act on owners of Alberta freehold mineral rights. Under the new act, if an individual suffers an injury as the result of another party's conduct, the individual has 10 years from the

occurrence of the event which gave rise to the injury to commence a legal action. It does not matter whether the individual knows of the injury or the event which gave rise to it, his right to sue effectively expires at the end of the 10-year ultimate period, unless there has been fraudulent concealment by the offending party.

Prior to the new act being proclaimed, legal actions in Alberta which alleged a breach of trust or a breach of fiduciary duty were not subject to a statutory time bar. In the opinion of some legal experts, an oil company owes fiduciary duties (duties of loyalty) to a freehold owner under a typical freehold lease agreement. The new Limitations Act effectively grants statutory immunity to oil company/lessees for discreet breaches of their fiduciary duty which occurred more than 10 years ago. In response to the Association's objections, Minister Hancock advised that the Legislature would be willing to re-address the issue if it became apparent that a significant tilting of the legal playing field had occurred.

The letters received by many freehold owner-members regarding improper gas royalty deductions raise a further problem with the new Limitations Act from the standpoint of freehold owners. As correctly set forth in the letters, the new act provides that if an individual knows, or reasonably should know, that he has suffered an injury attributable to the conduct of another, the individual has 2 years to commence litigation or his right to do so will effectively expire. But should unsolicited

letters, which contain information that a freehold owner may be unable to verify, trigger the running of the 2-year limitation period?

Members who receive these unsolicited letters and can not afford to retain their own legal counsel may feel considerable pressure to enter into contingency-fee recovery contracts with the company. The Association cautions such members to give careful consideration to their possible exposure to court costs.

In December of 1998, an Alberta Court of Queen's Bench judge ordered the freehold owner-plaintiffs in 21 legal actions to pay the oil companies they had sued approximately \$600,000 in costs. These costs related, not to trials of the freehold owners' individual cases, but to a trial of a preliminary issue of law imposed on the freehold owners by the Court at the request of the defendant oil companies. The judge considered it appropriate for the costs to be payable forthwith or immediately, before the trials of the freehold owner's individual actions, because "*the plaintiffs appear not to be paying the bills for this litigation*".

FHOA INITIATIVES

Publicity

One would have to be incredibly naive not to recognize that the effect of ordering citizens of ordinary financial means to pay \$600,000 to the oil companies they are suing before the trials of the citizens' legal actions have even begun would ordinarily be to put an end to the citizens' law suits and

preclude an appeal of the judge's decision on the preliminary issue of law. Would this cost decision, which effectively impinges on the fundamental legal right of every Canadian to a trial of all matters at issue in his or her law suit, have been made if the judge fully understood the plight of freehold owners? FHOA and presumably all Canadians who share our faith in the judicial system can only hope that it would not.

Over the next few months, the Association will attempt to draw media attention to the difficulties faced by freeholders.

Land Titles Issue

FHOA has been involved in discussions for a number of months with relevant departments of the Alberta and Saskatchewan governments regarding a possible error in the administration of these provinces' land title systems. The possible error and its implications for the property rights of owners of split title natural gas in these provinces will be more fully discussed in the next newsletter and on FHOA's web site.

Approaches to Industry Associations

The Angus Reid poll commissioned by PCF found that the oil and gas industry has significantly more credibility in the eyes of Albertans than either environmental groups or the industry regulator - the Alberta Energy and Utilities Board (the "AEUB"). Furthermore, 58% of Albertans

believe that the oil and gas industry is a good listener, and 53% believe that the industry is becoming more responsive to community concerns.

The Association has approached each of the major industry associations and the AEUB in an attempt to provide the industry and its Alberta regulator with an opportunity to listen to the legitimate concerns of our members and open a dialogue in which to address the resolution of these concerns.

Membership

Many members indicated in their membership application forms that they would be prepared to volunteer to help *FHOA* achieve its goals, but had no particular expertise and didn't know what they could do.

Perhaps you have other family members or neighbours who own mineral rights and would benefit from belonging to *FHOA* - if so, talk to them - 1100 members is a good start and provides the Association with some credibility, but there are 700 oil companies in Calgary alone and we need to increase the Association's membership to achieve our objectives.

Perhaps you know your MLA - if so, let us know and we'll add him or her to our mailing list - the support of members of the legislature is essential to the Association's success, but many MLA's don't understand that all we want is fairness.

Perhaps you know someone in the local media - if so, talk to them about *FHOA* and ask them to call us

- we have an interesting story to tell and the more people we tell the better.

If you have other ideas, let us know.

Although Manitoba and Saskatchewan do not have as much subsurface oil and gas as Alberta, they have many more freeholders. The Association has asked the governments of these provinces to provide the same sort of assistance in identifying freehold owners within their jurisdictions as was provided to *FHOA* by the Alberta Government.

On behalf of the board of directors,

Richard B. Riggins, President