

NEWSLETTER

The Freehold Owners Association (“FHOA”)

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THIS COULD HAPPEN TO YOU

What happens if the energy company that has leased your mineral rights and drilled a well on your lands suspends the well or shuts it in and continues your lease for years by claiming the well is “capable of producing the leased substances” and by paying you a \$1 per acre per year suspended well payment?

You could hire a technical expert to review the well and a lawyer to review your lease. You could direct your lawyer to initiate a legal action in an attempt to invalidate your lease. You could, but you probably wouldn't!

Firstly, very few of us have the financial resources to challenge an energy company in a court of law. Secondly, if you had entered into the form of lease agreement used by most energy companies, your lawyer would probably advise you that your chances of winning were slim. The energy industry knows this and, as a consequence, for decades unscrupulous energy companies have been holding freehold leases for speculative purposes with what for all intents and purposes are dry holes and token annual payments under the ‘shut in wells’ or ‘suspended wells’ clause.

FHOA is aware of situations where freehold leases have been continued for more than fifty years with no production whatsoever.

It could happen to you!

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ERCB Decision 2009-037

A Tentative Step Toward Fairness

Our March 14, 2009 newsletter focussed on the shut-in or suspended wells clause in freehold leases. We reviewed the historical development of the clause and how a clause which initially balanced the interests of the freehold owner-lessor and the energy company-lessee in a fair and reasonable manner had been bastardized by energy company lawyers .

We also reviewed our concerns with the Alberta Court of Appeal decision in *Kensington Energy Ltd. v. B. & G. Energy Ltd.* where the majority of the court ruled that the Kensington lease could be continued with what was essentially a dry hole. The reasoning of the majority was based on the intent of the parties to the Kensington lease. FHOA found it particularly troubling that the court would conclude that any rational freeholder would have such an intent. Our fundamental concern was that there was clearly no evidence before the court as to the freehold owner-lessor's intent as the involved freeholder was not represented.

In our last newsletter we also advised members of ERCB Proceeding 1584140. In issue in this proceeding was whether a CAPL 91 lease granted by one of FHOA's members to OMERS Energy Inc. had expired. The central question before the Energy Resources Conservation Board was whether a well drilled by OMERS was ‘capable of producing the leased substances’.

In Proceeding 1584140, unlike *Kensington* and the vast majority of the other judicial and regulatory proceedings involving freehold mineral rights, the involved freeholder was represented. FHOA sought and was granted the right to participate both in our own right as representative of freehold owners and on behalf of our member.

OMERS took the position that the phrase ‘capable of producing the leased substances’ should be interpreted to mean that any amount of production, no matter how small so long as it was measureable, was sufficient to continue their lease.

FHOA submitted that OMERS' interpretation would allow the lease to be continued indefinitely for speculative purposes without production and that this was contrary to the fundamental purpose of a freehold lease - to develop the mineral rights for the benefit of both parties to the agreement.

The ERCB released its decision in Proceeding 1584140 on May 12, 2009. In

Decision 2009-037 (available on the ERCB's website under 'Industry Zone' - 'Decisions'), the Board ruled that "*the lease established a contractual arrangement to facilitate production of the resource from the lands, with a resulting benefit for both the lessor and lessee.*" and that "*there must at least be some material, as in meaningful, volume of production possible for the lessee to rely on the suspended wells clause to extend the lease*". The Board concluded that OMERS lease had expired on its own terms.

ERCB decision 2009-037 represents the first tentative step towards ending the energy industry's unfair continuation of freehold leases for speculative purposes.

OMERS Energy Inc. Appeal

OMERS has sought and been granted leave to appeal the ERCB decision to the Court of Appeal of Alberta.

While FHOA is exceedingly pleased with ERCB Decision 2009-037, in our view the Board did not go far enough. During Proceeding 1584140, FHOA submitted that the Board should adopt the position taken uniformly by American courts - that 'capable of producing' means 'capable of producing in paying quantities'. The OMERS appeal provides FHOA with a potential opportunity to argue this issue in front of Alberta's highest court.

The ERCB Cost Order

FHOA is a not for profit association whose officers and directors are all unpaid volunteers. Although the vast majority of the association's work is accomplished by volunteers, it is necessary to retain legal counsel for regulatory hearings and judicial proceedings. Our success before the ERCB in both Proceeding 1584140 and the earlier CBM entitlement hearing attests to the excellent counsel provided to FHOA by Doug Rae and his partner Tibor Osvath of Rae and Company. Mr. Rae and Mr. Osvath are fully aware of FHOA's limited finances and do their best to minimize legal costs. But

regulatory hearings are by their nature expensive.

The ERCB Rules of Practice provide for local intervener costs which, according to the Board, are "*intended to benefit persons who have a legally recognized interest in specific lands, and who choose to participate in a Board proceeding in order to safeguard the benefits they are entitled to enjoy by virtue of their ownership of those interests.*" FHOA applied for local intervener costs in respect of its participation in Proceeding 1584140. We expected to recover at least a portion of our \$47,000 in legal costs. On August 11, 2009, the ERCB denied FHOA's cost claim on the basis that Decision 2009-037 impacted our member's rights under contract and not her rights in land. We consider this to be an error of law which if unchallenged will impact FHOA's ability to represent its members before the ERCB in other situations. On September 3, 2009 FHOA applied to the ERCB for a review of its cost order.

Irrespective of the results of the ERCB cost order review, funds expended in Proceeding 1584140 and on the coal owners' aborted application for leave to appeal the ERCB ruling in the CBM entitlement hearing have left FHOA seriously short of operating capital.

CBM Ownership Dispute Status:

We are advised that a case management judge has been appointed in the Court of Queen's Bench actions being carried forward by EnCana Corporation against a number of coal bed methane (CBM) developers who have produced CBM from split title lands. It is anticipated that these actions will be set down for trial sometime in 2010. The trial decision in these actions will almost certainly be appealed to the Court of Appeal of Alberta and leave to appeal the appellate court decision will probably be sought from the Supreme Court. When the final judicial decision is ultimately rendered it will vest ownership of billions of dollars worth of CBM in the hands of either the corporate

owners of coal or tens of thousands of individual owners of natural gas. It seems ludicrous for these legal actions to proceed without the freeholders whose property rights are in issue being represented. Unfortunately, FHOA cannot afford the estimated \$100,000 which would be necessary at a minimum to seek party status in these actions.

Upcoming Seminar:

FHOA's next seminar for freehold mineral rights owners will be held in the Norseman Inn, 6505 48th Avenue, Camrose, Alberta from 7:00 to 10:00 pm on Thursday, October 15, 2009. Guest speakers will discuss the impact of low gas prices on freeholders in the context of shut in wells, leasing and estate planning. The presentations will be followed by a question and answer session.

Newsletters:

Since FHOA increased its annual membership fee to \$50 from \$35 we have had a 33% decline in paying members. We have also heard comments from former paying members to the effect that FHOA is not doing enough to justify a \$50 annual membership fee. In an attempt to counter this perception, we intend to modify our policy of publishing two or three detailed newsletters each year and will instead publish shorter newsletters more frequently detailing our activities.

For those of you who have not renewed your membership we have attached a membership renewal form.

On behalf of the board of directors,
Else Pedersen, President
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