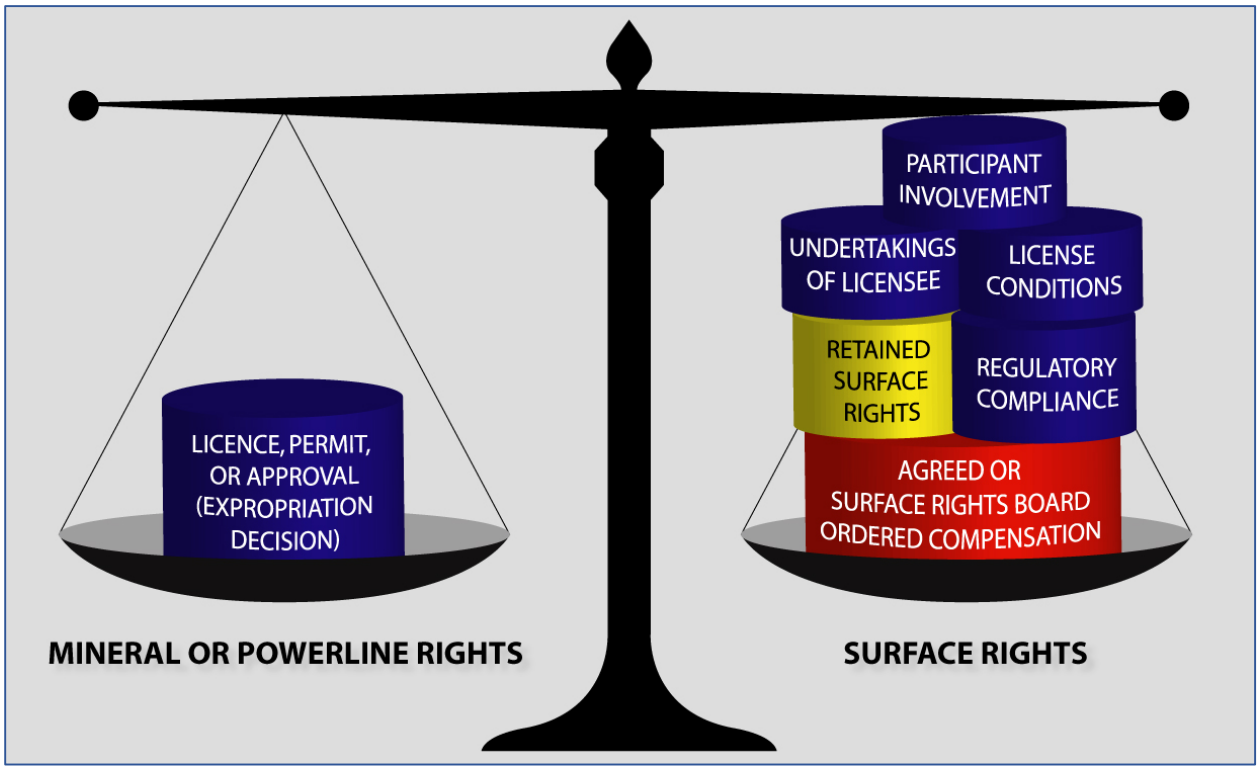
Surface Rights Compensation – A Balancing Act

Balance to be created by:

- ***The Alberta Energy Regulator or other Licensing Authority***
- ***The Surface Rights Board***



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Residential and Oil and Gas Development Can Co-Exist

Surface Rights Compensation - A Balancing Act

This document illustrates and outlines the basic principles of determining compensation to be paid to owners and occupants of Alberta land, when an operator obtains a licence, permit, or approval of a "licensing authority". Alberta's courts have deemed licence issuance to be the moment of an effective expropriation of surface rights, which rights are inherent in fee simple ownership of Alberta land.

One licence issuer, the Alberta Energy Regulator (AER), appears to be unaware it is making expropriation decisions, which affect the compensation of those whose rights are expropriated. Some simple pictures have been drawn to illustrate that portion of the AER's mandate this body has apparently overlooked.

An expropriating party (i.e., an oil and gas operator or power transmission line owner) must compensate those whose rights have been expropriated by a licensing decision according to the following principles:

1. The surface owner and occupant must be "made whole" for a force-taking of surface rights.
2. The owner and occupant must not be unjustly enriched (compensated for more than actual losses).
3. Because surface owners and occupants are not to be out of pocket related to a force-taking of surface rights, compensation is to be estimated on a forward-looking basis for a period not to exceed five years, and paid in advance, by the expropriating party.

Force-takings of surface rights (obtaining a right of entry to the surface of the land) can be accomplished by two means. Both means require the person to possess the underlying minerals, if any, to be accessed, and additionally require a valid licence or other approval for the surface activity to be conducted. The foregoing apply unless related activities are exempt from the need for a licence, permit, or approval (single oil well tank battery equipment is normally so exempt). The two means of obtaining a right of entry, which an operator as defined in the *Surface Rights Act* is entitled to ***seek*** once a licence or approval has been obtained, are as follows:

1. **Surface Lease Agreement:** An operator may obtain rights of entry by way of a private agreement between the operator and surface owner and/or occupant. However, these are not true lease agreements; whereby a landlord may evict a traditional tenant of the premises; the owner of an oil well, coal mine, or power transmission line cannot be evicted from these premises. ***Pursuant to the expropriation principles referenced above, compensation related to any force-taking of surface rights is patently not rent.*** (Operators generally and incorrectly refer to surface rights compensation as "rent").
2. **Right of Entry Order:** The Surface Rights Board ("**SRB**") may issue an order granting rights of entry.

Force-takings: If negotiations for a right of entry by way of a "surface lease" have been conducted and failed, and provided the operator possesses a valid licence and makes proper application, the SRB must issue a right of entry order when a licence, permit or approval of a licensing authority has been issued. Therefore, surface leases and right of entry orders are force-takings of surface rights arising from licensing decisions.

The SRB and licensing authorities have mandates and powers, which are provided pursuant to various "enabling statutes" or laws creating such bodies. The purposes of their mandates are to balance the rights of mineral or power line operators with the rights of surface owners and occupants, and the environment (plant and animal rights if you will). Their powers are the tools that should be used to carry out this "balancing act".

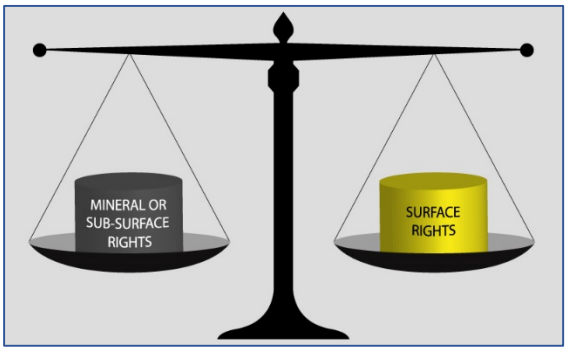
We, our clients, and Alberta's authorities, must thoroughly understand what "balancing tools" such bodies or authorities are required to use and how these tools provided to them by lawmakers should be used. Administrative bodies must carry out their mandates, and use their tools efficiently, effectively, and properly, to ensure that surface owners and occupants are "made whole" and are not out of pocket for long.

The final portions of this article deal with how to ensure landowners are made whole, which is not occurring.

Balancing Rights is an Ongoing Process

Balance of Rights is Upset by a Licensing Authority Approval for a Surface Activity

Prior to issuance of a licence, permit or approval by a licensing authority, the rights of mineral and surface owners and occupants are perfectly balanced. By using the scales of justice, this concept can be illustrated below.



Illustrated is the balance of rights prior to a decision to licence surface activities of an operator as defined in the *Surface Rights Act*.

The Licensing Body Must Minimize the Imbalance of Rights

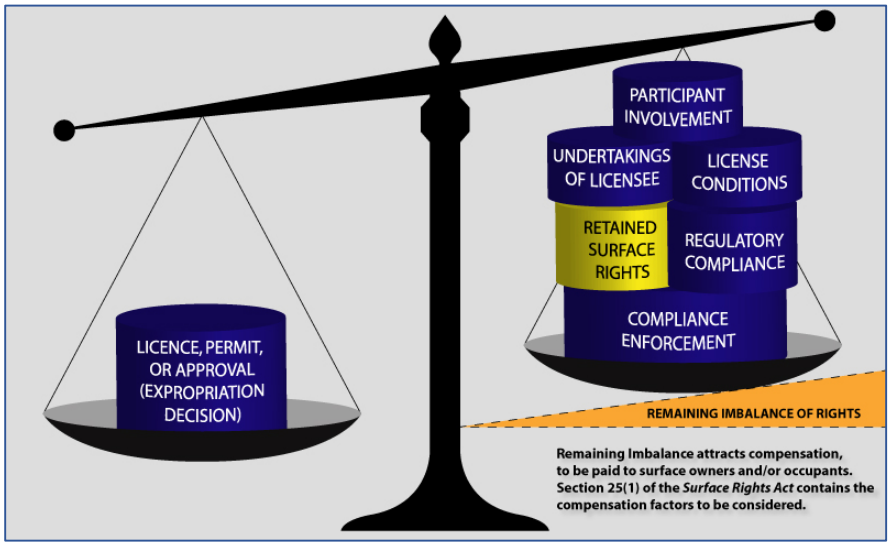
Our courts have found that, despite the fact that the SRB has sole jurisdiction or power to issue right of entry orders, it is really the licensing body that decides whether a force-taking of surface rights is fair and reasonably necessary (for the operations of the licensee to be carried out on the surface of land).

Landowners retain the rights to hold a certificate of title and to have the land revert back to them conserved and reclaimed (certified as reclaimed by the licensing body). Landowners may retain and assign other rights (such as to farm over a pipeline). Key compensation factors are the degree to which rights are taken or diminished by a licensing decision, which amounts and/or leads to a force-taking of surface rights.

It is the responsibility of the licensing body to ensure that the terms and conditions of a licence or approval minimize the adverse effects to surrounding land. All laws governing safe and regulatory compliant operations must also be applied. The inclusion of licensing terms and conditions, and regulatory compliance and enforcement, are the tools provided to licensing authorities by Alberta's Legislative Assembly to balance rights as much as possible.

The role of the Surface Rights Board is to *estimate* the compensation related to any remaining imbalance if requested to do so (if the operator and surface owner or occupant cannot agree as to quantum of compensation).

These concepts are illustrated below.



Illustrated are:

The initial minimization of an imbalance of rights created by licensing a surface activity, accomplished by licensing authority decisions (including terms and conditions of licence, reliance on underlying regulatory requirements, etc.).

The remaining, assumed, imbalance of rights attracting compensation, which must be agreed to or awarded by the Surface Rights Board.

Forward-Looking Compensation Decisions

The Court of Appeal of Alberta has found that the SRB's role, on each determination or redetermination of a rate of ongoing surface rights compensation, is to look forward, but not beyond five years. The party asking for the review has the burden of proving he is entitled to a variance from the previous compensation amount agreed to, or awarded by the SRB.

Thus, presumably because of the expropriation principle that a landowner should not be out of pocket in relation to a force-taking of his surface rights, the SRB must necessarily make assumptions in a forward-looking manner.

If assumptions relied on prove to be accurate over time, and no person requests a review and variance of a rate of ongoing compensation, agreed compensation or SRB awards may stand.

Expeditious, Reasonable, Expert, Decisions of Administrative Tribunals

Administrative tribunals, such as Alberta's licensing authorities and the Surface Rights Board, are charged with making low cost, reasonable, and expeditious decisions, using an appropriate degree of expertise and fairness. Their purpose is to minimize the work of courts, which may not have the same expertise, and reduce party costs.

When a tribunal makes a reasonable forward-looking assumption, such as an operator will fulfill an undertaking or operate in a safe and regulatory compliant fashion, and such assumptions, over time, prove to be correct, licensing and /or compensation decisions that prove to be reasonable need not be disturbed.

However, Alberta's courts have found, and it is common sense, that when the enabling statues of administrative tribunals contain review provisions, decisions, licences, and orders of these tribunals or not final and binding. In certain instances, original decisions must be reviewed and varied to maintain a correctness standard.

Reconsiderations of Former Decisions and Orders

The administrative tribunals that deal with surface oil and gas operations are the Alberta Energy Regulator (AER) and the Surface Rights Board (SRB). The enabling statues of these administrative tribunals contain review provisions.

The statute that enables and grants powers to the Surface Rights Board, is the *Surface Rights Act*. Pursuant to Section 29 of such statute this Board may rehear a matter, or may rescind, amend, or replace a former decision or order made by it. Section 37 of the *Surface Rights Board Rules* sets out the factors or reasons whereby the SRB either must, or may, reconsider a former decision or order.

The AER was created by, and its powers and duties are set out in, the *Responsible Energy Development Act*. Section 42 provides the AER with the power and authority to reconsider, and confirm, vary, suspend, or revoke its decisions.

Because the SRB and AER's enabling statutes contain review provisions, Alberta's courts have found that the decisions of these administrative bodies are not final and binding, and can reasonably be made expeditiously. If errors of jurisdiction, law, or fact have occurred, or if there is a change of circumstances, to list a few examples, an individual adversely affected by said decision is entitled to request a reconsideration.

Compensation reconsiderations are backward-looking. Reviews consider *actual loss* as opposed to *estimated loss*, where the latter relates only to initial forward-looking compensation determinations. Facts and actual circumstances are to be compared to previous assumptions when a compensation review is conducted.

In previously filed applications, the AER has taken the position that there is no provision for review and variance of licencing decisions by way of applications filed by landowners. This is simply incorrect. Moreover, this position constitutes a denial of a legitimate right to mount a jurisdictional challenge. Said position is also contrary to the provisions of both Alberta and federal law. Decisions or positions like these are nullities at law and jeopardize, or call into question, the AER's entitlement to make expeditious licensing decisions.

Compensation Must Not Be Based on Flawed Assumptions

The Consistency Mandate: Licensing Decisions Must Be Reflected in Right of Entry Orders

Because there are two bodies or boards involved in the statutory scheme requiring balancing of rights, our courts have found that they must work together. The SRB must ensure there are no inconsistencies between its orders and the decisions, approvals, prohibition orders, and the like, issued by the licensing authority.

The legislated procedures for these bodies to work together are as follows:

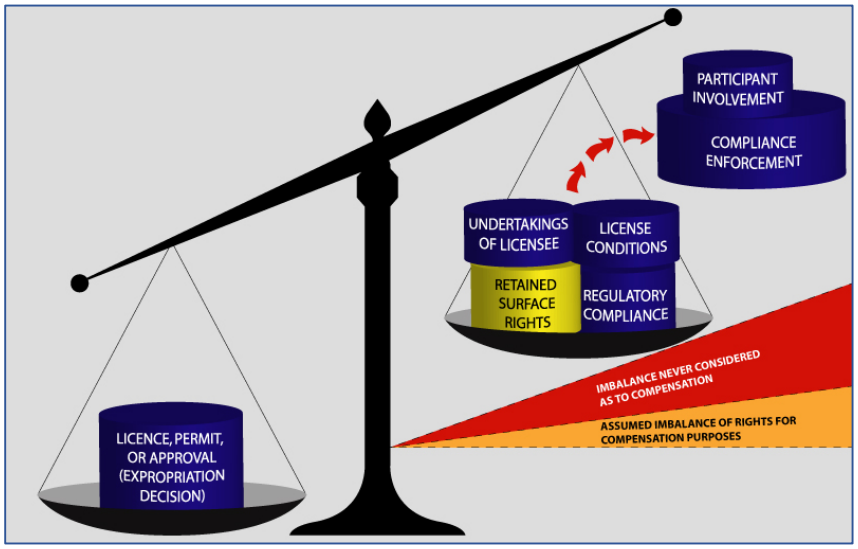
- Pursuant to Section 15(3) of the *Surface Rights Act*, the SRB should obtain all licencing authority decisions, approvals, permits, and related documentation.
- Pursuant to Section 15(6) of the *Surface Rights Act*, the SRB, if it has obtained such records, must ensure its orders are not inconsistent with related licencing authority decisions and approvals.
- The AER can conduct joint or cooperative proceedings with any government agency or another board, pursuant to Section 18(1) of the *Responsible Energy Development Act.*

Compensation is for All Imbalances of Rights, Regardless of the Reasons

There are numerous reasons why all force-takings of surface rights must be individually considered to determine the quantum of appropriate and legal compensation to be paid. Examples are: Each operation or taking is different. Each operator is different. Land on which surface rights takings occur differs.

Some reasons whereby compensation must be "higher than normal", or reviewed pursuant to errors or changes in circumstance, are listed below:

1. When inconsistencies between a licencing decision and an order of the SRB have not been detected or eliminated.
2. When the operator conducts illegal or unsafe operations, particularly if surrounding lands are impacted.
3. When a licensing authority fails to carry out its obligations, for example in the following regards:
   a) Failure to ensure a licensing decision is fair and reasonable.
   b) Failure to act on a complaint as to actual regulatory non-compliance, or failure to act reasonably in relation to regulatory compliance by licensees of oil and gas operations.
   c) Failure to file applications and related decisions in the licence application file, available to landowners, the SRB, and the public.



Assumed for illustration purposes: *The AER fails to enforce regulations prohibiting venting of natural gas, causing an unsafe area around a well or facility site.*
A compensation review, which considers the factors related to the red area is required.

The quantum of total compensation required by expropriation law principles must be for all imbalances of rights (the orange and red areas) according to changes in circumstances and any overlooked factors.

What is Occurring in Alberta

AER Decisions are Expeditious, but Landowner Review and Variance Requests are Blocked or Discarded

The AER regularly makes reasonable expeditious decisions every time it issues, or amends, a licence. When licenced wells, facilities, or pipelines are sold from one person to another, the related licences are ***usually*** amended.

However, some required amendments are overlooked. This can adversely affect an owner's rights, or the environment. The landowner (or any member of the public) is entitled to apply for a review and variance of a former decision. The problem is the AER's application intake policies and processes provide only for applications by licensees or prospective licensees. Consequently the AER has overlooked its mandate to balance the rights of landowners and environmental issues by illegally assuming landowners have no rights to request reviews.

If there is no process for correcting licensing errors caused by simple oversight, it is logical to infer that the AER is incapable of dealing with more complex regulatory noncompliance issues. Our experience shows this is the case.

AER Failures Adversely Impact the SRB's Ability to Carry Out its Mandate

In our considerable experience, the AER does not possess sufficient, or perhaps even the slightest, understanding of its true legislated role in the statutory scheme. Overlooked completely are the decisions of our courts, and the facts that each decision made by an AER employee has numerous potential implications. Overlooked are the following:

1. To carry out its mandate to compensate parties whose rights have been expropriated and or impacted by licensing authority decisions, the SRB must consider all of such decisions. Thus all licensing authority decisions must be set out in writing and available to the public, landowners, occupants and most importantly, the SRB. In contrast to the foregoing, the AER ignores landowner applications, issues verbal decisions, and fails to file written decisions in licence application files available to the SRB and the public.
2. Licensing decisions directly impact the quantum of compensation (for imbalances of rights) surface owners and occupants are entitled to receive by law.
3. The environment, including livestock and wildlife, are potentially affected.

Undetected Imbalances Cause Inadequate Compensation, and Create Safety and Environmental Issues

Irresponsible operators, and those who represent or testify for them, particularly in SRB proceedings, are experts at diverting Alberta's tribunals from considering actual circumstances, applicable case law, and the overall statutory scheme. Irresponsible operators seek, and are apparently happy to obtain, decisions that contain injustices for landowners, area residents, the environment, and taxpayers, and vigorously defend decisions improperly obtained.

Owners of urban lands, with the possible exception of those oil and gas towns like Redwater or Drayton Valley, are definitely undercompensated. Badly abused or completely ignored have been their rights to be safe on their lands, and those rights guaranteed by certificates of title. They have not been compensated for actual losses.

Residents, wildlife, travellers on Alberta's highways, and others, are put at risk by the actions of irresponsible operators.

Irresponsible Operators Exploit Systemic Breakdown

As our clients know, we would rather get on with development of lands we also manage, than file applications with Alberta's administrative tribunals. Doing so is impossible in today's Alberta. There is systemic breakdown in carrying out the mandates of the two-board statutory scheme to balance surface rights. This is to the benefit of irresponsible operators, who find it simple to exploit the shortcomings in the system.

The SRB Fails to Award Full Costs

A recent trend is that landowners are not recovering their costs that are related to hearings, when they have the burden of proof to prove damages; this discourages landowners from applying to the very boards that were set up to protect their rights, and constitutes an encouragement for operators to abuse landowner rights.

Landowners, Responsible Operators, and Taxpayers, Carry the Cost of Irresponsible Operations

Many operators act responsibly. Those who do not attempt to pass off liabilities, reserved solely for operators by law, on landowners, taxpayers, and more responsible operators. They are improperly being allowed to succeed.

Irresponsible Operators Must Be Required to Compensate for Actual Damages

Unfortunately, our experience is that, far too often, oil and gas operations are illegal and unsafe, and landowners and occupants have not been made whole accordingly, for a number of reasons.

A primary reason is irresponsible operators fail to conduct participant involvement properly, or at all. Landowners and residents, and consequently the SRB, do not know the nature of operations, the related inherent risks, or what should be done to properly mitigate safety risks and/or compensable damages.

One solution to the AER's inability or unwillingness to ensure regulatory compliance is to require irresponsible operators to pay higher compensation, pursuant to their legal obligations to do so. The current approach requires landowners to prove there has been a regulatory noncompliance, or that operators have failed to complete undertakings to mitigate damages. The opposite approach is preferable and conforms to expropriation principles.

For example, rather than requiring landowners to obtain adequate compensation by proving that undertakings made (to receive lower compensation awards) have not been completed by the operator, the following must occur:

- Operators with a record of failing to fulfill undertakings, or a poor regulatory noncompliance record, should be required to compensate the landowner until the undertaking has been fulfilled.
- Operators should be seeking reconsiderations that ***lower*** surface rights compensation, rather than requiring landowners to do the opposite. Compensation should be lowered when irresponsible operators have shown they have become responsible - after operations are rendered safe and regulatory compliant.

Solutions Offered by Dorin Land and Oilfield Management Inc.

We are in the unique business of restoring balance between the rights of operators, as compared to the rights of surface owners and occupants. We also ensure land is conserved and reclaimed. We do so solely at the cost of the operator or expropriating party, or the person solely responsible, pursuant to Alberta law.

We offer practical grass root solutions. We provide solutions of many types to landowners at no direct cost. We invoice the operator, or alternately apply to the SRB for an order directing irresponsible operators to pay for actual damages, as required by law. We actually ensure landowners are not out of pocket, and that they do not absorb the legal or other costs associated with applications to the AER or SRB.

First we review the nature of licensing decisions and surface rights takings. If necessary we request review and variance of licensing decisions. If the results of AER applications are unreasonable or incorrect, we assist those entitled to compensation to receive what they are entitled to by law, through Surface Rights Board applications.

Landowners currently have two *terrible* options to choose from as to new takings of surface rights:

1. Accept an inadequate surface lease agreement offered by the operator.
2. Be subjected to the implications of a right of entry order that ultimately provides less protection of rights than even a poorly drafted surface lease agreement would provide.

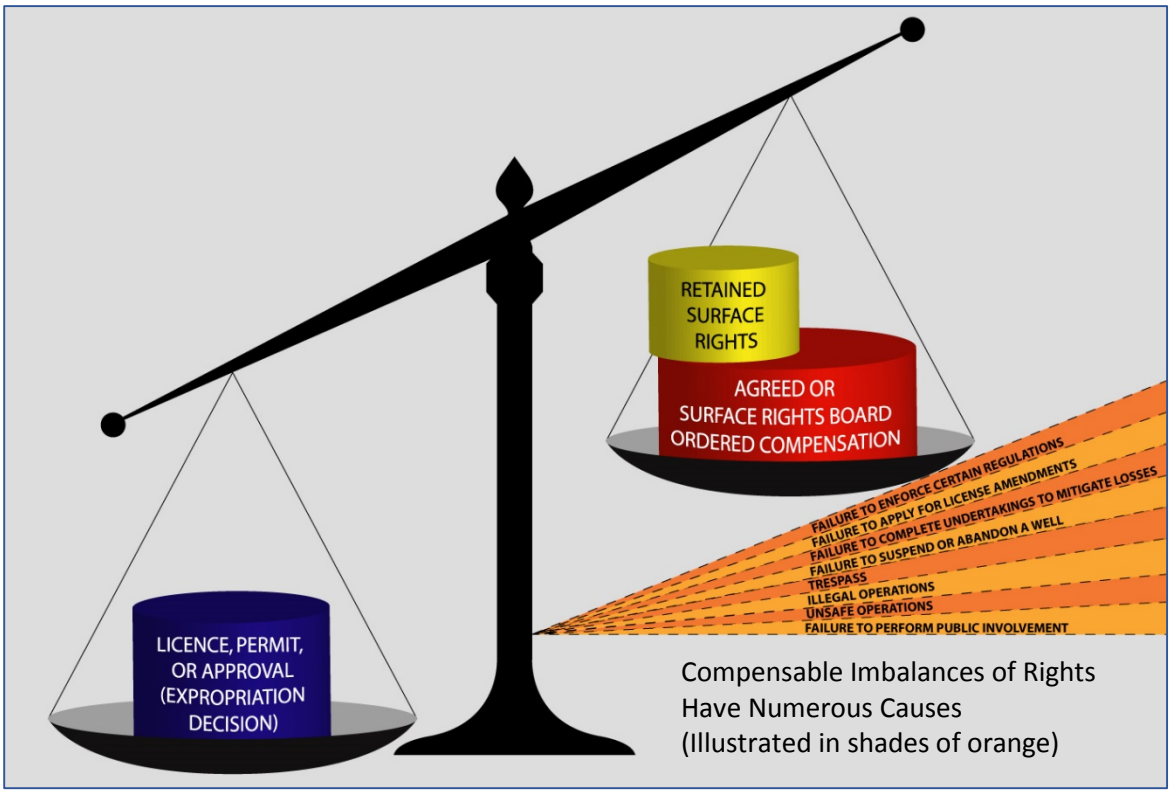
We offer new or additional choices, which we believe are preferable to the foregoing:

- The owner requires the operator to enter into one of our comprehensive surface lease agreements
- We work to ensure right of entry orders are issued that contain provisions that actually protect landowner rights, and actually reflect licensing decisions.

When a right of entry order has been issued, we work to ensure the SRB determines compensation for actual imbalance of rights, on an ongoing basis, in the event the operator refuses to agree to compensation of this nature.

What we do for landowners can also be illustrated, as has been done below.

Our Solutions Illustrated



When licensees fail to operate legally and/or safely, or the licensing body fails to ensure regulatory compliance, or for other reasons illustrated in the orange triangles in the figure above, compensable imbalances of rights are created, which are inconsistent with previous compensation assumptions.

The only solutions available to landowners by law are:

1. Request the operator and/or licencing authority to eliminate or compensate for the imbalance (illustrated in shades of orange above).

2. If the operator and/or licensing authority fails to act, request the Surface Rights Board to award proper compensation for all imbalances and resultant damages as required by Alberta law.

Pursuing the foregoing requires knowledge of the nature of operations and of the complex statutory scheme. One must have knowledge of dozens of laws and related regulations, related case law, and contract law.

Unless landowners have access to the advice of qualified operational personnel, which is currently not the case, and qualified legal advisors, imbalances go undetected. Inadequate compensation is agreed to or awarded.

Related to safe and legal co-existence of residential and other development with oil and gas development, we also advise and/or consult to towns, cities, municipalities, land developers, and responsible operators.

In short we advocate and promote responsible oil and gas development, which is safe and regulatory compliant, and properly recognizes landowner rights and the principles of natural justice.