Freehold Mineral Ownership

What is freehold mineral ownership?

Freehold (FH) mineral ownership occurs where a private party holds the rights to subsurface mines and minerals. In Alberta, subsurface mines and mineral rights are based on the surface area which they underlie. A specific parcel of freehold mineral rights is referred to as freehold mineral title. “Mines and minerals” generally includes coal, oil, natural gas, oil sands, metals, minerals, gemstones, and other subsurface resources, with exceptions. About 8.4 per cent of Alberta’s mineral rights are owned by freehold owners.

Each freehold title is unique by location. Often, certain minerals are not included in a particular freehold mineral title. For instance, it is rare for gold and silver to be included in freehold mineral title, as those metals are reserved to the Crown. Also, coal may not be included in freehold title acquired from a railway company.

What mines and minerals are included?

To know what mines and minerals are in a particular freehold title, check the Title Certificate, the *Mines and Minerals Act*, and Part 7 of the *Law of Property Act*. For complicated titles, or heavily fragmented titles please consult with independent legal counsel.

What rights does freehold title confer?

Holding freehold title gives the following rights:

- The owner has some rights to develop them and may be able to compel the surface land owner to allow them access to develop them.
- A freehold owner can alienate freehold title, by outright sale
- A freehold owner can also grant rights to develop the mines and minerals by way of lease or licence. This means they allow someone else to produce from the title, usually in exchange for a small sum plus a royalty on what is produced.

Freehold mineral rights may have been obtained by:

- Early settlers (1872-1877)
- Included in the sale of lands from the Canadian Pacific Railway (1880’s)
- Purchased from other freehold owners
- Inherited as part of an estate

More information is available on mineral ownership.

Fragmentation

Inheritance has led to the fragmentation of many freehold mineral rights. This means industry operators with an interest in developing those mineral rights have to contact multiple owners to secure lease rights. This will not only cost an operator additional time and money, but may fail to result in the unanimous agreement the operator requires. This is particularly important to freehold mineral rights owners that intend to will their rights. More details are available in the *Land Titles Act.*

©2018 Government of Alberta | Published: May 2020

The registrar may refuse to accept the registration of any instrument transferring, encumbering, charging or otherwise disposing of an undivided fractional interest in a parcel of land containing mines and minerals, or any mineral, and being less than an undivided 1/20 of the whole interest in mines or minerals, or in any mineral contained in that parcel of land.

There are two ways to solve this multiple owner issue:

- Owners can set up a trust with a mineral rights lawyer to handle the freehold mineral rights on behalf of the family. To find a lawyer call the Law Society of Alberta at 1-800-661-9003.
- A pooling agreement can be formed to identify different owners in the separate tracts within what is called a “drilling spacing unit.” A drilling spacing unit is an area of land that an oil or gas well is assumed to drain. A spacing unit for oil in Alberta is typically a quarter-section of land. For natural gas, it is one section. The pooling agreement determines the shares of the costs and revenues associated with drilling and producing a well from that spacing unit. This follows the Oil and Gas Conservation Rules. “No well shall be produced unless there is common ownership throughout the drilling spacing unit.”

The Alberta Energy Regulator, under Section 80 of the *Oil and Gas Conservation Act*, has a process for a company to apply for compulsory pooling. This is an order that allows the company to drill without a lease from the freehold mineral owners. This can occur when:

- the owner fails to negotiate a satisfactory pooling arrangement in a reasonable period of time;
- a tract owner is missing and untraceable; or
- there is a dispute about the ownership of a tract.

Lease Negotiations

Freehold mineral lease agreements for development are negotiated between the owner of the rights and the company wanting to produce from those rights. Usually the freehold mineral owner will be approached by a representative or land agent acting on behalf of the interested company.

The representatives who negotiate with freehold mineral owners are not required to be licensed land agents under the *Land Agents Licensing Act.* Most land agents, and the companies they represent, use freehold lease agreements developed by the Canadian Association of Petroleum Landmen (CAPL). Companies have no obligation to use standard CAPL leases and may use other lease forms or make amendments to CAPL leases to suit their needs.

In negotiating a freehold mineral lease agreement, the freehold owner should understand both the terms and conditions in the lease agreement and the technical circumstances surrounding their mineral rights. As with any legal contract, freehold mineral owners should get independent legal and technical advice prior to signing.

The importance of the negotiation process cannot be overemphasized. The provisions of the *Surface Rights Act* do not apply to freehold mineral leases. If a freehold owner owns less than the entire spacing unit and refuses to enter into a freehold mineral lease agreement with a company, the company can seek a compulsory pooling order.

Compensation

A freehold owner is typically paid a small amount upon signing, typically around $10.

A caveat reflecting the lease should be registered on the Certificate of Title at the Land Titles Office by the company that signed the lease.

The company will likely register a caveat on the freehold mineral owner’s Certificate of Title to protect its rights under the lease. A caveat should be registered as soon as possible because the priority on the Certificate of Title is given based on the date of registration, not the date of execution or lease date. The caveat registered against the Certificate of Title provides notice to other parties of the company’s interest while the lease determines the rights, terms and conditions.

Leases can be transferred from one company to another company throughout their life. The caveat on the Certificate of Title retains whatever priority the previous company had. The new caveat holder must update the information on the Certificate of Title with Alberta Land Titles if the agreement is changed, updated or if the contact information changes.
Once the agreement is signed, the company will register a caveat on the Certificate of Title with Alberta Land Titles to confirm it is the only caveat on the Certificate of Title regarding the leased mineral rights. The date of the caveat registration determines the priority—not the lease or execution date—and this is in place for the term of the lease. The caveat registered against the Certificate of Title provides notice to other parties of an operator's interest, while the lease determines the rights, terms and conditions.

Once the caveat has been filed with Alberta Land Titles and it has been confirmed that no conflicting caveats exist on the Certificate of Title, the owner will be paid the "bonus" or "additional consideration," which is typically significantly larger than the initial amount. An owner may want to clarify with the company when the bonus will be paid, as different versions of the CAPL lease have different provisions.

Once production is established, the owner will receive a royalty based on the royalty rate and the cap on deductions negotiated in the freehold lease agreement.

In recent decades, negotiated royalty rates have varied between 12.5 and 18 per cent. In 2016, the Government of Alberta introduced a 5 per cent royalty to be paid on Crown leases until the payout of the deemed drilling and completion costs of the well. This has impacted the amount freehold owners can negotiate in order to remain competitive with Crown mineral rights.

Leases can be transferred, but the new lessee and caveat holder must update the caveat, along with any other changes on the Certificate of Title with the land titles office.

Freehold Mineral Tax

Almost all freehold mineral lease agreements indicate that the Freehold Mineral Tax is shared between the company (lessee) and the freehold mineral owner (lessor) based on the ratio of the company's working interest and the freehold owner royalty interest.

A freehold owner could become responsible for the tax if the company becomes insolvent prior to paying their agreed share of the tax or if the company refuses to pay. The freehold owner must then pay the outstanding tax or risk having their freehold mineral title cancelled and the rights vested in the Crown. In this circumstance, freehold owners may want to seek independent legal advice.

Terms to Know

Suspension

A well may be formally shut-in or suspended if its operation is not currently economically viable but may become so in the future. This practice is more common with gas wells than oil wells.
Under current Alberta legislation, a company can leave a well suspended indefinitely. During suspension, some contracts allow the company to continue the lease by paying $1 per acre. Different contracts may contain alternative provisions.

Freehold mineral owners who are negotiating a new lease may try to incorporate a limitation for how long a well might remain suspended before the rights return to the owner. A freehold owner with an existing lease should have legal counsel examine the wording in the suspended or shut-in wells clause in their particular lease.

Offset wells clause

A freehold mineral owner may use the "offset wells clause" in the lease to force the company to take action if a well on an adjacent property produces commercial volumes of oil or gas.

Petroleum and natural gas move about in the subsurface in response to pressure changes.

©2018 Government of Alberta | Published: May 2020

Production of oil or gas from any well results in a pressure reduction around the subsurface wellbore, causing oil or gas within the productive reservoir to flow toward the producing wellbore. This can result in oil or gas from one tract of mineral rights flowing into a wellbore on another tract of mineral rights. The oil or gas produced from a well has no label indicating from where in the subsurface it originated. This inability to identify the source of produced oil or gas resulted in the early courts developing what is known as the "Rule of Capture." Under the Rule of Capture, a mineral owner owns whatever oil or gas comes out of a well legally drilled on the land above their mineral rights, no matter where that oil or gas came from in the subsurface, or vice versa.

Offset well obligations are sometimes neglected and freehold mineral owners are advised to periodically monitor their mineral rights for drilling activity on neighbouring lands.

Deeper rights reversion

Newer leases may have a deep rights reversion clause. This allows for petroleum and natural gas rights below the base of the deepest productive zone to be freed from a lease, allowing for development of deeper zones by other parties. The department of Energy's information letter 1998-14 discusses deeper rights reversion in detail.

In order to alert other potential lessors to the availability of these formations, the caveat on the Certificate of Title should be amended to reflect the deep rights reversion.

Continuation

The length of the primary term of a freehold mineral agreement—typically three years—is negotiated between the freehold mineral owner and the company. It can be continued after the primary term, if the lease has a habendum clause. This provides the operator with the flexibility to continue operating after the primary term, provided it is a producing well. The company can continue a lease after the primary term either through continued operations or through the shut-in/suspended well clause of the freehold mineral lease.

In order to continue most CAPL leases under the shut-in wells clause, the well has to be capable of meaningful production. Under these CAPL leases, payment under the shut-in wells clause is not enough to continue the lease.

Some non-CAPL leases do not have a shut-in clause which is important because this means they can only be continued past the primary term if production continues.

Language can differ greatly from lease to lease, particularly on pre-CAPL leases, and it is strongly recommended that an owner seek independent legal advice when reviewing, enforcing, or entering into a lease.

©2018 Government of Alberta | Published: May 2020