HOW DO WE EXAMINE POLICIES OF LEASE HOLDER COMPENSATION?

COMPENSATION MODELS FOR ENERGY SECTOR IMPACTS ON ALBERTA CROWN GRAZING LEASES

GRAZING LEASES IN ALBERTA

What are grazing leases? More than 6.3 million acres (3.9 per cent of the province) of publicly owned Crown agricultural lands in Alberta are leased to individuals or corporations for livestock grazing. This leasing system was established before the creation of the province of Alberta.

Who is compensated when leased lands are disturbed? Grazing lease holders in Alberta receive compensation from oil and gas operators when development is undertaken on lands that they lease. Compensation to public lands grazing leaseholders is generally determined through privately negotiated agreements and this information is not publicly available.

Why is this significant? Questions have recently been raised by Alberta's Auditor General about the system of compensation for Crown grazing lease lands. A number of alternative policies from jurisdictions such as Saskatchewan and the Municipal District of Taber have been cited.

STUDYING A COMPLEX ISSUE

What is the purpose of this study? This project provides a comparison between potential policies for the compensation of leaseholders for oil and gas disturbances on Crown grazing leases.

Is this part of the recent Alberta Auditor General investigation? No, this study is independent of the Alberta Auditor General's recent investigation into grazing lease management.

Are there additional factors relevant to this subject? Our analysis identified that compensation payments to grazing lease holders form one part of an economic system that also includes rental rates and the determination of value through compensation decisions. Any future change to Alberta's compensation policy should take into consideration the complexities of this entire system.

What comes next? Rental rates for Alberta's grazing leases are currently under review, so additional research should await any changes, to allow the function of the entire system to be assessed.

ALBERTA LAND INSTITUTE

Launched in 2012, ALI is an independently-funded institute based at the University of Alberta, conducting impartial, policy-driven research in the areas of agriculture, municipal development, water, and governance and regulation.

THE RESEARCH TEAM

Stacey O'Malley, MSc was a Research Associate with the Alberta Land Institute at the University of Alberta when drafting the paper.

Alicia Entem, MSc was working as a Research Associate at the University of Alberta when drafting this paper and is currently a Fellow at the Smithsonian Tropical Research Institute.

Eran Kaplinsky, LL.B., LL.M., SJD, is an Associate Professor of Law at the University of Alberta, where he specializes in property and planning law. He is also the co-author of the ALI publication, *A Guide to Property Rights in Alberta.*

W.L. (Vic) Adamowicz, PhD, is the Research Director of the Alberta Land Institute and a Professor in Resource Economics and Environmental Sociology at the University of Alberta.

This is a summary of the ALI report "Alternative Models Of Compensation On Alberta's Crown Grazing Lease Lands." To download the complete paper, visit:

albertalandinstitute.ca/grazing-leases

HOW DO OTHERS COMPENSATE?

EXISTING AND PROPOSED GRAZING LEASE DISTURBANCE COMPENSATION POLICIES

FIVE APPROACHES TO COMPENSATION

The current Alberta system allows lease holders to establish compensation through private negotiation (see page 4), but different protocols exist in other jurisdictions. Saskatchewan and the Municipal District of Taber have different models, and the Government of Alberta has previously proposed two alternatives. The table below indicates how each policy would compensate Crown land grazing leaseholders and government for wellsites in the first year, and annually. Though compensation is provided for other types of oil and gas development, wellsites were selected because they allowed the most direct comparison between policies.

Policy	Leaseholder Compensation: First Year	Leaseholder Compensation: Annual	Compensation to Government from Operator
Current Alberta Policy	Privately negotiated between public lands grazing leaseholder and oil and gas company	Privately negotiated between public lands grazing leaseholder and oil and gas company	Standard fee prescribed by the Minister for the surface oil and gas lease
Current Saskatchewan Policy	$500 per wellsite	Reduction in annual rental fees of $200 per wellsite, to a maximum of a 30% reduction in annual rental fees	Land under surface lease removed from the grazing lease; operator pays standard lease and rental fees
Municipal District of Taber Policy (starts February 28, 2016)	$800 per surface mineral lease	$400 per surface mineral lease	100% of all revenue derived from the operator
Thurber Report (proposed policy)	$500 per wellsite	$300 per wellsite, capped at the amount the leaseholder pays in 'yearly agricultural fees'	First year payment and annual rental from the operator
Charges Regulations (passed but never proclaimed)	$500 per acre or part thereof for wellsites (states that a 'site' is typically 4 acres)	$300 for first 1-3 sites; $200 for next 4-10 sites; $100 for over 10 sites, to a maximum of $5,000 per development	$500 per acre in the first year, $300 per acre in subsequent years

ALBERTA ALTERNATIVE

On March 26, 1997, Premier Ralph Klein appointed MLA Tom Thurber to chair a review committee that would undertake consultation on the issues surrounding agricultural leases in the province, with special emphasis on grazing lease issues.

In May of 1998, the Agricultural Lease Review Committee released an Interim Report (the "Thurber Report") outlining its findings, providing initial recommendations to the Legislature, and soliciting further public feedback. The changes suggested in this report, as well as the resulting 'Charges regulations' (which were passed but never proclaimed into law) can be seen in the table to the left.

AUDITOR GENERAL REPORT

In July 2015, Alberta's Auditor General office examined this issue. Working with Alberta Environment and Parks, investigators obtained specific information from 54 grazing associations, holding 72 leases (approximately 600,000 acres, or 10% of the Crown land currently leased for grazing). Of these associations, 40 reported receiving a total of $3,000,000 in compensation for disruptions on leased Crown land, while paying $327,000 in rent to the province.

The report extrapolated that, if these amounts were consistent across all leases, some $25,000,000 in compensation payments would be retained by public lands grazing leaseholders, instead of the Government of Alberta.

www.albertalandinstitute.ca
albertalandinstitute@ualberta.ca
780-492-3469

HOW DO THE POLICIES COMPARE?

TO COMPARE THE APPROACHS, WE APPLY THE SAME ESTIMATES TO EACH

A "BASE CASE" COMPARISON

Our research shows that, as of 2013, there were 33,421 wellsites on Crown lands grazing leases in Alberta. We do not know the precise rate of compensation currently being paid to each Crown lands grazing leaseholder by oil and gas companies for each wellsite (see page 4), but we have estimated the amount to be $1,500 per site (see sidebar). Based on these figures, we estimate that the total amount of compensation for oil and gas wellsites currently being paid to Crown lands grazing leaseholders in Alberta is $50,130,000 per year.

Note: A previous version of this background document incorrectly listed the number of wellsites in Alberta as 7,388, which is the number of grazing leases in Alberta. This error was not made in the full report.

COMPARISON OF COMPENSATION BY POLICY

Policy	Total Government Compensation	Total Leaseholder Compensation
Current Alberta Policy	n/a	$50,130,000
Current Saskatchewan Policy	$44,378,000	$5,752,000
Municipal District of Taber Policy (starts Feb 28, 2016)	$36,762,000	$13,368,000
Thurber Report (proposed policy)	$40,443,000	$9,687,000
Charges Regulations (passed but never proclaimed)	$45,525,000	$4,605,000

DISTRIBUTION OF WELLSITES

On average, there are 4.52 wellsites on each Crown lands land grazing lease in Alberta. Based on our estimated compensation of $1,500 per wellsite, that means the average grazing lease currently receives $6,785. However, some grazing leases have more wellsites than others. Approximately 45% of the province's grazing leases (or 3,312 of 7,388) currently have no oil and gas wellsites, while the top 30 per cent (2,217 of 7,388) collect as much as 93% of total annual compensation payments to all Crown lands grazing leaseholders.

ESTIMATING AVERAGE COMPENSATION

In order to compare policies, we need to understand how much public lands grazing leaseholders are being compensated for wellsites on their leased Crown land.

For the purposes of this analysis, $1,500 per wellsite was selected as an estimate for current annual compensation levels from oil and gas operators to public lands grazing leaseholders across Alberta.

This number is an estimate because rates are determined through privately negotiated agreements. Precise compensation rate values for public lands grazing leaseholders across the province are therefore not available.

To determine an estimated compensation rate, Surface Rights Board decisions were examined. A 2007 decision noted that eight examples of $1,500 annual rate of compensation for wellsites on grazing lease lands was becoming 'a pattern'. In the Board's five most recent decisions related to compensation as of November 2013, the annual rate of compensation for a wellsite on grazing lease lands has been at least $1,500 (with an average of $1,610).

The amounts presented here are likely to underestimate financial implications of the alternatives. This analysis includes oil and gas wellsites only, while compensation can be provided for other private infrastructure, including pipelines, lease roads, transmission lines and oil and gas facilities.

DOES THE SYSTEM FUNCTION?

THE ALBERTA SYSTEM FOR ESTABLISHING COMPENSATION MAY BE IMBALANCED

BALANCING BENEFITS AND COSTS

Compensation from oil and gas operators to grazing lease holders might appear to be payment for the use of Crown property. However, these payments are intended to compensate lease holders for disruptions to their grazing operations.

In addition to all other surface and subsurface fees paid to the government of Alberta, payments from oil and gas operators to grazing lease holders promote a productive use of public lands while ensuring that the benefits of development outweigh the economic costs.

Other jurisdictions in Canada use different systems (see pages 2-3) to achieve this outcome; in Alberta, private negotiation within a regulatory framework is the chosen method. However, if the economic system in which private payments are established is not balanced, resources can be mis-allocated.

RENTAL RATES AND COMPENSATION

Compensation to lease holders is paid as part of an economic system that also includes multiple factors, such as:

1. **Rental rates** paid by grazing lease holders to the Alberta Government. These rates have been frozen in the province since 1994.

2. **Compensation values** established in private negotiations, but which can be challenged before the Surface Rights Board (SRB). As the mechanism to resolve disputes over access rights, the SRB determines compensation in each case based on precedent and established patterns of private dealings.

In theory, compensation payments are in balance when rental rates accurately reflect the value of the leased land (to the owner, the province of Alberta), and the compensation rates set by the SRB accurately reflect the disruption for which lease holders are being compensated.

In Alberta, compensation payments are difficult to assess, as most agreements are private. It is also difficult to assess the level of compensation provided by the SRB, because its decisions are not necessarily based on site-specific assessment of the cost of disruption.

Rental rates likely do not reflect current market conditions, because they have been frozen for twenty years. With the support of grazing lease holder groups, the government of Alberta is currently reviewing rental rates for grazing leases. Once updated, these rates will influence the allocation of resources within the economic system.

TRANSACTIONS WITHIN THE ECONOMIC SYSTEM

To understand the system in which compensation is paid, it is necessary to recognize three different transactions related to oil and gas development on leased Crown grazing land:

1. Grazing leaseholders pay the province of Alberta for grazing rights on Crown lands (regardless of whether there is oil and gas development on the property). This transaction is governed by the *Public Lands Act and Regulations*.

2. Oil and gas operators pay the province of Alberta for mineral exploration on Crown lands (regardless of whether or not the lands are used for grazing), including the right to access the surface and establish a wellsite, and the mineral rights themselves. This arrangement is governed by the Province's oil and gas laws, the *Public Lands Act and Regulations*, and the *Surface Rights Act*.

3. Oil and gas operators compensate grazing leaseholders for disruptions to their cattle operations on Crown land. The amount of compensation is negotiated privately, or determined by order of the provincial Surface Rights Board. These dealings are governed by the *Public Lands and Regulations* and the *Surface Rights Act*.

For the natural resources in question to be used to the greatest advantage of all Albertans, all three transactions must reflect the true cost of everyone's operations.

www.albertalandinstitute.ca
albertalandinstitute@ualberta.ca
780-492-3469