

File No. 1733
Board Order No. 1733-1

April 23, 2013

SURFACE RIGHTS BOARD

**IN THE MATTER OF THE PETROLEUM AND NATURAL GAS
ACT, R.S.B.C., C. 361 AS AMENDED**

**AND IN THE MATTER OF
THE NORTH EAST ¼ OF SECTION 22 TOWNSHIP 87 RANGE 18 WEST OF THE 6TH
MERIDIAN PEACE RIVER DISTRICT
(The "Lands")**

BETWEEN:

Elysha Petersen

(APPLICANT)

AND:

Penn West Petroleum Ltd.

(RESPONDENT)

BOARD ORDER

Heard: March 7, 2013 in Fort St. John
Appearances: Elvin Gowman, for the Applicant
Darron K. Naffin, Barrister and Solicitor, for the Respondent

INTRODUCTION

[1] This is an application for rent review pursuant to section 166 of the *Petroleum and Natural Gas Act (PNGA)*.

[2] The surface lease, originally executed in 1988 between the then owner of the Lands and Encor Energy Corporation Inc., grants right of entry, occupation and use to 4.88 acres of the Lands for an access road and oil well. Penn West Petroleum Ltd. (Penn West) assumed the lease and the operations on the Lands in 2008. Mr. Elysha (Lysh) Peterson purchased the Lands in the spring of 2011, and later that year sought to review the annual rent of \$3,000.00 last reviewed effective December 13, 2003. Lysh Peterson seeks to increase the annual rent to \$8,805.00. Penn West submits the annual rent should be \$3,778.00. The difference between the parties is attributed to their differing views on the compensation payable for loss of use or loss of profit, nuisance and disturbance, and severance.

ISSUE

[3] The issue is to determine the appropriate annual rent payable under the surface lease. The effective date of any revised rent is December 13, 2010, being the anniversary of the lease immediately prior to Lysh Peterson serving Penn West with a Notice to Negotiate.

FACTS

[4] The Lands are located approximately 35 kms north of Fort St John in the Rose Prairie area. They are used to grow crops, in particular canola, wheat, barley, and peas. The soil is classified as Class 2c, with moderately high to high productivity for a wide range of crops. The Lands slope from west to east.

[5] Lysh Peterson is a third generation farmer. He grew up farming, starting to assist his father at a young age. His father, Don Peterson, commenced renting the Lands in 1993 or 1994 making them part of the family farm. Lysh Peterson purchased the Lands for \$160,000 in the spring of 2011. He planted and harvested his first crop as owner of the Lands that same year. He farms in partnership with his brother. Together they farm approximately 15 quarters of land generally in the Rose Prairie area.

[6] The lease area is not located on Lysh Peterson's home quarter.

[7] The lease area consists of a 3.27 acre well site and 1.61 acre access road, comprising in total 4.88 acres. The well site is located approximately in the centre of the quarter section with the access road effectively dividing the north portion of the quarter section in half. Approximately two thirds of the eastern half of the quarter section remains treed.

[8] The onsite equipment includes a well head and a fence. The well last produced in 1989 and was formally suspended in 2011. The fence is in poor repair, with parts of it broken and sagging, particularly on the west side of the lease area. The fence does not conform to the boundaries of the lease, effectively leaving part of the lease area available for cultivation. The access road is gated, but the gate is in poor repair and is generally left open.

[9] There used to be oil tanks on the leased area, but they were removed sometime during the 1990's.

[10] There is approximately 125 meters between the fence along the south east edge of the well site and the treed area. The area between the south east edge of the well site and the trees is wet in the spring. In some years, the wet area cannot be cultivated and divides the Lands into two fields, one comprising 33 acres in the north east of the Lands (the "little field") and one comprising 81 acres on the western portion of the Lands (the "big field"). In some years, the two fields are separately cultivated.

[11] There is a naturally occurring slough along the north boundary of the Lands abutting the road and just west of the access road.

[12] The site is rarely visited. Penn West or its contractor attended the site once during the summer of 2011 and once during the summer of 2012 to attend to weeds on the leased area.

EVIDENCE AND ANALYSIS

[13] Section 154(1) of the *PNGA* lists the various factors the Board may consider in determining an amount to be paid periodically or otherwise. Of the various factors enumerated in section 154(1) of the *PNGA*, those principally in issue in this application are:

- (c) a person's loss of right or profit with respect to the land;
- (e) compensation for severance; and
- (f) compensation for nuisance and disturbance from the right of entry.

[14] I heard evidence from Lysh Peterson, Don Peterson, Robert Telford, and Nolan Treble with respect to the factors in issue. Additionally, I received evidence from Mr. Treble of other surface leases in the Rose Prairie area, and heard argument with respect to the applicability of the Board's decision in *McDonald v. Penn West Petroleum Ltd*, SRB Order 1742-1. I will, therefore, also consider the factors identified at section

154(1)(i) and (j), namely, terms of surface leases submitted to the Board and previous orders of the Board.

Loss of right or profit

[15] Although Lysh Peterson has only owned the Lands since 2011, he and his father have cultivated the lands since the early 1990's. In 2010, they grew barley in the big field and canola in the little field. I was not provided any evidence of actual yields or actual profits from the Lands or any other quarters farmed by the Petersons.

[16] Lysh Peterson claims \$450 per acre based on the Board's description of evidence provided by Mr. Telford in the *McDonald* decision. In that case, Mr. Telford gave evidence that the rate paid for crop land is \$450 per acre. Mr. Telford's evidence in this case was that his evidence of \$450 per acre for cultivated lands in the *McDonald* case was based on a number of negotiated agreements that indicated payment of \$450 per acre for loss of profit for cultivated land in the area of the McDonald land, located approximately 2.5 miles east of the Fort St. John airport. His evidence was further, that empirical data indicates that actual loss of profit is less than \$450 per acre.

[17] Mr. Telford provided statistical data on the average five year yield, average market price between 2006 and 2010, and market price as of December 2010. On the basis of these statistics, he estimated the gross return per acre as of December 2010 for canola at \$357.28, wheat at \$286.52, barley at \$225.09, and peas at \$276.36. Mr. Telford estimated expenses associated with seed and fertilizer, potential pre-seed, post-emergent, and pre-harvest sprays at \$120 to \$150 per acre resulting in net returns per acre for canola of \$207.28, for wheat of \$166.52, for barley of \$125.09, and for peas of \$156.36. Based on a four year crop rotation, Mr. Telford's evidence was the average gross loss of use would be \$286.31 per acre and the average net return would be \$163.81 per acre. Based on Mr. Telford's evidence, Penn West submits loss of profit should be calculated as follows:

4.88 acres @ \$286.31 per acre = \$1,397.19 per annum.

[18] While I accept Mr. Telford's, or anybody else's, ability to provide the Board with statistical data respecting average yields and prices, it is not evident from Mr. Telford's report the source of his expense estimates nor his professional qualifications that would enable him to provide an opinion on the average net return. Perhaps as a Professional Landman and Licensed Land Agent in Alberta he has experience with both negotiating and reviewing compensation packages that may enable him to form an opinion of amounts typically paid, but his qualifications do not identify any expertise in agriculture or as a farmer. Furthermore, \$286.31 per acre does not seem reasonable when compared to amounts paid under other leases.

[19] Mr. Treble provided a binder of leases negotiated in the area and provided some evidence with which to compare these leases to the subject. Of the two leases that relate to cultivated land, the amount of the lease rate attributed to loss of profit is not

evident. The amount of the lease rate attributed to loss of profit is only evident in six of the 11 leases provided, and ranges from approximately \$250 to approximately \$450 per acre, averaging \$327.55 per acre. The land use for these six leases is described as either pasture or hay. It is not possible to discern from the leases whether other factors, including possible other sources of income loss or factors not related to actual loss, contributed to negotiated amounts at these levels. Mr. Treble's evidence was that, generally speaking, he would expect to see higher compensation for loss of use in relation to land that is cultivated than for land used for hay or pasture. It is likely when the negotiated rates are compared to Mr. Telford's statistical evidence of average probable return, that negotiated crop loss rates are typically based on gross rather than net yields, and may often reflect factors not associated with actual crop loss.

[20] While the evidence indicates that sometimes landowners are compensated at a rate of \$450 per acre for loss of profit, the evidence does not support that Lysh Peterson's actual or reasonably foreseeable loss of profit can be expected to be as high as \$450 per acre. The statistical evidence suggests that the highest probable gross return from the leased area could be just over \$350 per acre if planted in canola. Compensation at \$450 per acre would over compensate Lysh Peterson for loss of profit from potential crop loss attributed to the leased area. While \$350 an acre does not account for expenses or for crop rotation, I accept \$350 per acre as reasonable given the evidence of other negotiated rates. I estimate Lysh Petersen's loss of profit as follows:

$$4.88 \text{ acres @ } \$350/\text{acre} = \$1,708.00$$

Severance

[21] Lysh Peterson claims \$1,600 per annum for severance. This figure reflects 1% of the price he paid for the Lands in 2011. He submits the leased area creates severance in two locations. One is the area between the access road and the slough and the other is the wet area between the south east boundary of the leased area and the treed area. Penn West submits there is no severance.

[22] Severance occurs where the landowner loses the use of land in addition to the land subject to a lease as a result of the presence of the lease.

[23] Lysh Peterson attributes the wet area to the presence of the lease. His evidence was the area becomes rutted with spring run-off from the lease area. Don Peterson's evidence was that the first spring he rented the Lands, the lease area was bermed and filled with water. The water was pumped out. At some point during the time Don Peterson rented the Lands, the berm was either breached or broken with the result that water washed into the field to the south east of the well site. The company operating the site at the time apologized. Don Peterson's evidence was that most of the time, the little field and the big field are cultivated separately because the wet area and the lease area together effectively create two separate fields.

[24] In some years, as is evident from the 2010 aerial photograph in Mr. Telford's report, the little field and the big field are separately cultivated and the wet area is either not seeded because it is too wet too late into the spring, or if it is seeded, the crop does not survive. In some years, however, as is evident from the 1998 aerial photograph also in Mr. Telford's report, and the 1997 aerial photograph filed as Exhibit 3, the entire field, including the wet area, can be cultivated as a single field with a single crop.

[25] The land slopes naturally from west to east. Water will therefore tend to run towards the treed area. Any berming on the leased area will result in the accumulation of water, and any break in the berm on the downslope side will cause the water to be directed through the break in a concentrated way into a particular area. On the basis of Don and Lysh Peterson's evidence of their observations of water flowing into the wet area from the leased area, which evidence was not contradicted by Penn West, I am satisfied that the presence of the lease likely contributes to making the area to the immediate south east of the lease wetter than it might otherwise naturally be in the absence of the lease. Even with the natural slope of the land, it is odd that the wet area would be concentrated where it is and not be more widespread on the eastern portion of the Lands if the presence of the lease does not contribute to directing water into the area.

[26] The evidence does not establish that the leased area creates a permanent severance of the wet area. In some years, the wet area dries sufficiently to enable cultivation and to allow the entire field to be cultivated as a single field, and there is no severance of this area. The evidence does establish, however, that in a wet year, the presence of the leased area together with the wet area effectively divides the field into two fields and necessitates their separate cultivation. In a wet year, the wet area cannot be cultivated and there is some severance. The size of the wet area has not been calculated in the evidence before me.

[27] As to the area between the slough and the access road, I accept Lysh Peterson's evidence that the presence of the access road creates a small space between the access road and the slough that is difficult to access with farm machinery, creating a small amount of severed land. The exact size of this area has not been calculated in the evidence before me.

[28] I do not accept Lysh Peterson's submission that severance should be calculated as 1% of the Land's value. The loss to a landowner from a severance will generally be the loss of profit from that area, in addition to any amounts for nuisance and disturbance attributed to a severance, and not a loss bearing any relationship to the property's market value.

[29] While I am satisfied there is some minimal permanent severance of a small area between the access road and the slough, and in some years there is severance of an area between the leased area and the trees to the south east of the leased area, I have insufficient evidence with which to determine the amount of any severed area either on

an annual or periodic basis. However, to acknowledge and compensate for some severance mostly of a periodic nature, I find it is not unreasonable to assume an average additional one acre loss, or \$350.

Nuisance and Disturbance

[30] Nuisance and disturbance may be both tangible and intangible. Tangible nuisance and disturbance includes impacts on the landowner that are capable of quantification, typically in time or additional expense incurred by the landowner as a result of the presence of the lease. Intangible nuisance and disturbance accounts for impact on the landowner that is not capable of calculation and will necessarily be more subjective, such as the effect of noise or dust.

Tangible Nuisance and Disturbance

[31] Penn West does not dispute that the leased area causes nuisance and disturbance by making the Lands more difficult to farm and causing additional time to be spent on various farming activities. The parties disagree, however, on the extent of the nuisance and disturbance and the additional time required to farm around the leased area.

[32] Lysh Petersen provided drawings to illustrate the path the farm equipment must take as a result of the lease compared to the path it would take if the lease was not there. His evidence was that it is difficult to farm around the slough because of the access road. He explained how after doing the headlands, he had to work the fields inside of the headlands and showed, with the assistance of illustrations, the areas of inevitable overlap. He explained how sometimes he would have to make two trips to the quarter section with each piece of equipment, once to do the big field and again to do the little field, depending on conditions.

[33] Lysh Petersen's evidence was that in a typical year he would undertake seven to twelve passes of the field for the purpose of spraying, harrowing, fertilizing, seeding, swathing, combining, baling and discing. He estimated, on the basis of his own experience and discussions with his father and brother, that an additional one hour for each operation was required to farm around the leased area. Using a rate of \$250 per hour, being the rate used in the *McDonald* decision, he calculated \$3,000 attributable to the extra time required to farm around the lease.

[34] Lysh Petersen also calculated the expenses attributable to overlap as a result of farming around the lease including: the cost of spray, nitrogen fertilizer, phosphate fertilizer, and seed ranging collectively from \$258.33 to \$333.95 based on the cost of spray, fertilizer and seed, the size of his equipment and his calculated area of overlap. He also calculated an area of compaction arising from additional turns and travel on the headlands around the lease perimeter at 1.17 acres. He submitted loss should be based on $\frac{1}{2}$ of his requested crop loss figure, or \$225 (1.17 acres x $\frac{1}{2}$ of \$450/acre). He also sought an additional \$250 for the difficulty farming into the corner between the lease road and the slough based on an additional five minutes per implement. He

claimed \$3,808.95 as his total estimated annual loss attributable to the nuisance and disturbance of farming around the leased area.

[35] Mr. Telford's evidence was that a typical farming operation in the area consists of seven operations. He disagreed that 12 operations, as indicated by Lysh Petersen, was consistently necessary. Making various assumptions about the size of equipment and speed of travel he used a computer model to calculate additional farming time and losses attributable to overlap or from unseeded areas as a result of turns. The calculations indicated annual tangible loss related to farming around the lease area attributable to additional headlands, additional realignment, additional turns, crop loss due to unseeded area, additional inputs and compaction of \$1,981.32. Mr. Telford provided a second calculation using the computer model based on Lysh Petersen's evidence respecting the number of operations and the size of equipment. This second calculation (Exhibit 6) was \$2,799.41. In Mr. Telford's view, Lysh Petersen's estimate of one additional hour for each operation was excessive. He acknowledged that the computer model is based on numerous assumptions.

[36] For the most part, I accept Lysh Petersen's calculations of loss attributable to farming around the lease area over those provided by Mr. Telford. I accept Mr. Petersen's evidence with respect to the number of farming operations required on an annual basis and his estimate of additional time for each operation. Mr. Telford's qualifications to provide an opinion as to typical farming operations and time required for farming operations is not evident from his report. Mr. Telford is a real estate appraiser and land agent, not an agronomist or professional farmer. He does not appear to have the professional qualifications to provide the offered opinions. Mr. Petersen, on the other hand, has been farming for many years and has actual experience working this and other land. His calculations are based on his own experience using his own equipment. I accept Mr. Petersen's estimate of additional time for each operation to farm around the lease and his claim of \$3,000 annual compensation attributable to this factor.

[37] I also accept Lysh Petersen's claims for additional expenses related to lost spray, fertilizer and seed of \$333.95. I find it is not necessary to add the additional estimate of time to farm into the corner between the lease road and the slough, as that time is accounted for in the additional hour to farm around the lease for each operation. I accept it is appropriate to estimate loss due to compaction at one-half the rate of full crop loss. As I have allowed \$350/acre for crop loss, I calculate the loss from compaction at \$204.75 (1.17 acres x \$350/acre x ½).

[38] Lysh Petersen claimed an additional \$1,200.00 which he attributed to intangible nuisance arising from the presence of weeds, potential contamination, and the unsightly appearance of the lease.

[39] Penn West does not control weeds on the leased area to Lysh Peterson's satisfaction. He has to be vigilant to ensure that weeds, in particular scentless chamomile, do not spread into the fields. His evidence was that he has often needed to

rogue scentless chamomile that has spread from where it grows along the access road. To the extent Lysh Petersen has to spend time rogueing weeds, or incurs expense to manage weeds that have spread from the lease site, that time and expense may be compensated as tangible nuisance and disturbance. He ought not to have to incur time and expense dealing with weeds if Penn West is appropriately managing weeds on the lease. I do not have an estimate of Lysh Petersen's time spent dealing with weeds. Mr. Telford suggested one day on an annual basis for additional landowner's time associated with the presence of the lease, such as in dealing with contractors and the company. In the absence of other evidence of Mr. Petersen's time associated with the lease beyond his additional time in farming around the lease, I accept one day (8 hours at \$50/hour = \$400.00) as appropriate.

[40] I estimate the compensation payable for tangible nuisance and disturbance as follows:

Additional time to farm around lease	\$3,000.00
Additional expenses	\$333.95
Compaction	\$204.75
Additional time generally	\$400.00
Total	\$3,938.70

Intangible Nuisance and Disturbance

[41] Lysh Peterson expressed concern about possible contamination of the Lands. Don Peterson's evidence was that on two occasions he observed oil within the berm around the storage tanks prior to their removal. His evidence was that there is "crusted stuff" there now. Lysh Peterson has concerns about contamination spreading from the leased area into the field with water run off and has concerns about potential liability. The evidence falls short of establishing that there is in fact contamination either on or off the leased area. I accept however, that Lysh Peterson is concerned about contamination and that his concern is not entirely groundless given the former presence of oil tanks combined with observations of oil within the bermed area and observed run off. I accept that the concern causes worry and stress. This worry and stress creates an intangible nuisance and disturbance.

[42] Lysh Peterson described the leased area as a blight. He expressed dissatisfaction with its unsightly appearance as it does not fit with the rest of the quarter. While the leased area was in its present state when Lysh Peterson purchased the Lands, he hoped he could get its unsightly and unkempt condition addressed. His evidence was that the previous owner lived in Edmonton and did not care about the appearance of the lease. While it is not clear from the evidence that Mr. Petersen actually brought his concern about the fence to the attention of Penn West, it is clear from the evidence that the fence is damaged, and has been for some time. I agree it is unsightly and unkempt, and therefore, causes intangible nuisance.

[43] There is little in the way of operator traffic to this wellsite due to the well being suspended. Just because a well is suspended, however, does not relieve the operator of the obligation to maintain the lease or minimize the impact of the lease on the landowner.

[44] The loss attributable to the intangible nuisance caused by this lease is incapable of calculation. Relative to other more invasive nuisances such as noise and dust, however, the intangible nuisance is somewhat minor. A small amount – say \$500 – to acknowledge the intangible nuisance and disturbance is appropriate.

Other leases

[45] As discussed above under loss of profit, Mr. Treble provided a binder of other leases all negotiated in 2010 for comparable purposes. On a per acre basis, the 11 leases range from a low of \$795 to a high of \$1,197. He considered a lease of 4.89 acres approximately one mile away also with class 2 soil to be the best comparable. This lease is somewhat similarly positioned in the quarter section, but is on a home quarter and has a shorter access road. The land is used for hay. The rate per acre indicated by this lease is \$981.

[46] The only other lease of cultivated land with class 2 soil is in the same section as the lease described above and also very close to the subject. The lease area is 3.8 acres. It is a suspended oil well with a much shorter access road, but is on a home quarter. This is the lease indicating the highest per acre rent at \$1,197.

[47] While the leases provide some indication of what other landowners are receiving in rent in the Rose Prairie area, without a breakdown of how the rent is calculated and the particular losses accounted for in the rent, it is very difficult to compare other leases to the situation at hand.

Other Decisions

[48] Lysh Petersen relied extensively on the *McDonald* decision in advancing his claims. While the Board's determinations on matters of law or principle in one case might reasonable apply to another case, the Board's decisions on matters of fact determined from evidence will not apply unless the evidence in a subsequent case is the same. Loss attributable to a surface lease should be substantiated with evidence. Because one landowner is able to substantiate loss, does not mean that another landowner will necessarily experience the same loss. A number of factors go into establishing the appropriate annual compensation for a well site including the location, use and productivity of the Lands, and the nature and extent of any nuisance and disturbance. Much of the evidence in the *McDonald* case with respect to these factors was different than in this case, so the Board's findings in *McDonald* will not necessarily apply to the circumstances of this case.

Change in the value of money and of land

[49] Section 154(2) of the *PNGA* mandates that in reviewing the rent payable under a surface lease the Board must consider any change in the value of money or of land since the rent was last determined.

[50] The current rent of \$3,000.00 was negotiated in December 2003. I have no evidence as to the change in the value of the Lands or other land in the area between December 2003 and December 2010. Lysh Petersen purchased the Lands for \$160,000 in 2011, indicating market value of \$1,000.00 per acre.

[51] As for the change in the value of money, Mr. Telford provided evidence indicating an increase of approximately 11.35% in the consumer price index between 2003 and 2010. Applying an 11.35% increase to the current rent would indicate rent of \$3,341.00. This amount falls well below what I have determined above to be Lysh Petersen's actual anticipated reasonable losses attributable to the lease.

Determination of Global Sum

[52] Applying my findings discussed above in relation to the various factors in issue, I estimate Lysh Petersen's ongoing annual loss as follows:

Loss of profit	\$1,708.00
Loss due to severance	\$350.00
Tangible nuisance and disturbance	\$3,978.70
Intangible nuisance and disturbance	\$500.00
Total	\$6,536.70

[53] Stepping back and considering the compensation globally in light of the evidence before me and the principles of compensation binding upon me, and acknowledging the subjective and necessarily arbitrary nature of some of the estimates, I round that figure down, and conclude that \$6,500 per annum represents an appropriate rent to compensate Lysh Petersen for his reasonably anticipated loss arising from the lease. I acknowledge that on a per acre basis, this amount exceeds the highest rate indicated by the comparable leases provided in evidence before me. I am satisfied, however, that Lysh Petersen has demonstrated on a balance of probabilities the loss he is likely to incur as a result of the lease, and the impact of the lease to him. Some of these losses, such as loss of profit and tangible nuisance and disturbance can be reasonably estimated based on quantifiable measures and somewhat objective criteria. Some of the losses and impacts cannot be calculated on the basis of any quantifiable measure. They are impacts on the landowner nonetheless, and need to be acknowledged in the payment of annual rent.

ORDER

[54] The Surface Rights Board orders that effective December 13, 2010, the rental payment under the subject lease shall be \$6,500.00 per annum. Penn West Petroleum Ltd. shall forthwith pay to Lysh Petersen the difference in annual rent paid since December 13, 2010 and the revised annual rent effective as of December 13, 2010.

DATED: April 23, 2013

FOR THE BOARD



Cheryl Vickers, Chair