



▪WILLIAM D. MARRIOTT & ASSOCIATES LTD.▪

139 Royal Birkdale Drive NW, Calgary, Alberta T3G 5R8
(403) 239-2516 cell (403) 554-1390

Industry Reviews the Surface Land Compensation Database

© 2010 William D. Marriott and Associates Ltd.

April 13, 2010

Introduction

The Canadian oil and gas industry is in the process of a massive restructuring. Conventional drilling has been in continuous decline for 5 years, with 2009 recording the lowest numbers in two decades, 75% lower than the peak in 2005. The larger companies with global perspectives are shifting their investments out of Alberta or focusing on higher cost unconventional plays. Meanwhile, the local industry is acquiring assets and finding new ways to take advantage of opportunities closer to home. The local service industries are also re-inventing themselves in the hopes of being more competitive in this new environment. The Surface Land Compensation Database ("the DB") (www.wdmarriott.com) has been operating continuously since 1995, providing compensation research capabilities and aggregate analysis to oil and gas operators, land consulting firms, industry associations and governments. ***As with the industry and its support industries, the DB needs to re-examine and re-invent its products and practices*** in order to adapt to this new environment.

The Review

While there have been many innovations in terms of data collection, quality control and distribution, universal acceptance of the DB has proved illusive. For example, even though there has been a nearly 60-70% commitment *in principle* from the largest operators, the database only receives about 30-40% of all the surface leases taken. The main supporters of the DB have requested a comprehensive industry review of the objectives, principles, and operation of the DB. The purpose of this review is to determine what (if any) improvements can be made to the DB to increase its use, acceptance and participation or whether the ongoing operation of the DB can be justified. In addition, ***the review will also survey operators and brokers to determine their views on surface compensation research methods as well as general compensation issues, policies and practices*** and whether they feel the DB and aggregate analysis will help in addressing those issues.

Review Process

The process to achieve the current review of the DB will consist of a small number of open consultative meetings with the industry's leaders to review the history, development and issues facing the DB. ***The primary focus of the review will be on 'What's wrong with the field tool DB'?*** We are looking for a list of the impediments that prevented moving from the 'in principle' support for the DB, to the practical implementation of a comprehensive and accurate DB. Despite operator's best intentions, data fails to be transmitted to the administrator. All topics are open for discussion including: (i) content and collection of the DB data (eg should additional information be collected?), (ii) the format and delivery of the data (eg on maps using IHS and others), (iii) the administration of the DB (eg through one of the trade associations, CAPL or AASLA), (v) the governance of the administrator (eg with member user-group meetings or a Board of Advisors), (vi) the funding of administrator costs (eg who benefits – who pays?). Based on the views expressed in these meetings and other input from interested parties, the supporters of the DB will recommend changes to industry and then seek agreement and endorsement to move the DB in a new direction. Alternatively, the main supporters may recommend that the DB cease to continue.

Participation

We are asking anyone who desires to provide your views through your company's lead Surface Land person so they can then forward these along at the consultative meetings. Failing that please provide any comments directly to Bill Marriott (bill@wdmarriott.com).

Deliverables

The following are the deliverables from the review:

- 1) A forum for an open review of surface compensation issues and a open review of the DB products, strengths and weaknesses,
- 2) A survey of operators and brokers to determine their views concerning compensation issues, policies and practices, and their use and support of the DB,
- 3) A report to industry on the results of the survey and the identified DB issues and possible solutions,
- 4) A recommendation to industry to either continue with the DB in a new form or alternatively to recommend that the DB cease to continue,
If the DB continues, the new product will provide:
- 5) A list of operator supporters who will i) supply data and ii) provide funding, in order to reveal where the DB lacks coverage,
- 6) A list of brokers who will i) deliver data as directed by their operator/clients, and ii) utilize the DB as a research tool in their field work, in order to reveal who will cooperate and who will have the DB as a minimum knowledge base.

Timing

The following is the tentative timing for the review:

April 13 – identification of issues and possible solutions,
 survey operators on compensation

May 11 – ‘Waterloo’ decision meeting;

Review operator survey results and report from April 13th meeting,

Decision to continue or cease made by paying customers,

If continue, list of recommendations for change.

If the DB is to continue then:

May 26 – Broker meeting to solicit cooperation,

May 27 – Operator meeting to announce ‘new and improved’ DB,

June 1 – Commence administration changes, roll-out to industry,

Sept. 1 – Go ‘live’ with new system.

DB Products

While the DB is almost universally known as a field tool to research detailed and particular compensation, it also has other important functions. These arise out of the availability to analyse large amounts of data (data mining). **Another important function is an administration function to support the calculation of rent review values.** In this function, the data is not used to determine competitive ‘market values’ at a specific location but rather to analyse a broader geographic area to see how aggregate values have changed over time. Then a rent policy is set to ensure equitable treatment of landowners for that geographic area. Depending on the rent policy of the company, this administration function can be complicated or simple but requires specific custom analysis of large amounts of data.

Yet another important function is the aggregate analysis of the industry as a whole. This includes industry trend analysis and company benchmarking. Overall pricing and individual heads of compensation components are changing over time and the data allows for an aggregate analysis of how much change is taking place, both in aggregate and in the individual components. Further, price movements are not uniform through the province so the unique characteristics of different areas can also be analysed. A recent study concluded that rates in Alberta are rising very quickly but that the rapid increases are not due to the corresponding

increases in the fundamentals of real estate values or agricultural receipts. See “Price Determinants in Alberta Surface Compensation” at the WDM site (www.wdmarriott.com).

Field Tool Objectives

The original objectives of the DB were motivated by the desire of the producing industry to make all the details of field compensation transactions available to outside operators and land agents in the most efficient and comprehensive manner possible. In two words, **research efficiency** was the primary objective in order to minimize compensation research costs. The intent was to reduce their internal administration costs in providing information and to eliminate any subjective elements which might hinder accurate communication. By having their data on an independent external database they reduced the time their own staff would need to adequately inform outside agents, while at the same time providing fast, accurate, objective, and comprehensive data to anyone who desired it. **More often than not, these companies were not that interested in seeing what other operators were paying but rather wished to ensure that their own compensation rates were easily transparent to others, particularly those on the periphery of their core operations.**

The hope was that administrative costs would be reduced both by the providers of the data and the users of the data while at the same time ensuring as much accuracy as possible. The proponents of the DB all had comprehensive compensation policies which they used to set their own compensation rates. Their motivation was to make sure that these policies were easily understood by outside agents by releasing the actual compensation amounts paid.

A secondary objective was the widespread belief that better information in the hands of agents will expedite the negotiation of surface leases. **More information in the marketplace will increase the efficiency of the market and lead to more competitive and consistent pricing.**

DB Principles

Since its inception, the fundamental values driving the DB have been transparency, efficiency, professionalism, and cooperation - the removal of any barriers or restrictions to the free flow of information. Included in these core values is a respect for the principles of surface compensation and the conventions used by industry. All of the contributors to the DB accept the overriding principle that landowners are to be fully compensated for their losses, and they all use the heads of compensation, both on their lease agreements and in their reporting to the database.

Equity is another core value, in that all contributors believe that all landowners should receive equal treatment under their compensation principles. **Not only is compensation to be fair and adequate, it is also to be equitable between landowners.**

Full disclosure is also a core value of all contributors to the DB. The effectiveness of the DB is seriously undermined if some ‘extra’ compensation paid to a landowner is not reported or some ‘bad deals’ are unilaterally excluded. It makes no sense for the biggest operators to go to all the trouble to provide their data only to have confidence in it undermined by the belief that it is biased or incomplete. The pricing dynamics of the surface ‘market’ is complicated but tends to be driven by the ‘bad deal’ exceptions, anomalies or outliers and the ability of the agricultural community to quickly and accurately communicate those exceptions. **Industry agents need to be at least as well informed as those advocates advising landowners.**

The most recent significant innovation in the DB is in data capture directly from the operator's land systems without any human intervention, now accounting for about 40-50% of all the data received. These are the same systems that are used to pay the landowners ***so all data and all leases are being accurately transferred to the DB.***

DB History

The DB originated as an initiative of producers in the CAPP Surface Land Committee in 1995. At that time, committee members felt that a different approach was necessary to ensure that agents were adequately informed about field compensation. The principle of cooperative information sharing was long established but the 'word-of-mouth' methods of exchanging that information often failed to provide enough detail or proved to be 'too little, too late' to adequately meet the needs of the agent.

The committee proposed a feasibility study of an centralized, independent, external DB to track and distribute detailed compensation information. The committee was unanimous in its support of this new method and 15 of the largest operators signed up for a pilot project. Two years later the original 15 were joined by 7 more large subscribers and commitments to supply data were made by 60 of the top 80 drillers accounting for 75% of all drilling. This overwhelming majority support 'in principle' by operators has not wavered in the intervening years. ***The DB is essentially an association of producers who wish to share detailed surface compensation data in order to maximize knowledge of their field activities.***

The feasibility study made a thorough review of all the issues surrounding the establishment of the DB including the legal issues. CAPP's Legal Committee and CAPP General Counsel reviewed the DB to ensure that the industry and CAPP would not be in violation of any statutes by sponsoring the formation of the DB. The legal review focused on competition and privacy issues. ***The committee concluded that the collection and publication of compensation data is not, in itself, a violation of the Competition Act.*** The privacy issues of 1995 were eclipsed in 2004 by the Alberta Personal Information Protection Act (PIPA) and other provincial privacy Acts. The increased liability faced by operators as a result of this legislation, and the possible inability to produce evidence for Surface Rights Board hearings, has caused virtually all lease agreements to now contain clauses which give consent to the disclosure of the lease 'personal information' by both the landowner and the operator.

DB Implementation

CAPP was very clear in 1995 that it did not want to be involved in the administration of the DB. Further, the proponents insisted on low costs and a user-pay subscription service. Since Marriott had undertaken the feasibility study and run the pilot project, the company was a natural to operate the database on behalf of the proponents. A number of land brokers had bid to be the DB administrators but it was decided that this would create a conflict of interest. Rather, Marriott became the administrator since they had no interest in the surface land business.

Originally, all data was submitted using the fax machine and paper reports (hence the Marriott Report) were distributed to the subscribers. Eventually, area reports and sophisticated DB queries were available over the Internet, and finally data was captured at the website as well.

Along the way, ***the basic field tool function of the DB led to broader administration applications and aggregate analysis looking at the industry as a whole, including corporate benchmarking.*** CAPP also utilized the DB for analysis in support of lobbying efforts on surface rights issues. Individual clients and groups of clients sponsored trend analysis studies and benchmarking. Even more extensive analysis is possible because now there is a raw data source available. For example, providing a Surface Rights Board 'score card' on whether decisions accurately reflect what is paid in an area, is possible using the DB. To date the DB has achieved significant data coverage with over 3000 records per year coming in. However, this still leaves data gaps that cause the users concern.

DB Ongoing Issues

While the principle of the DB was universally accepted by producers, the population of the database has proved difficult since going from 'principle' to implementation has faced many challenges. In general, any change in the manner of doing business is resisted and so it was with the implementation of the DB. Many land agents felt it was a threat to a necessary function that only they should perform for the industry, and even after 15 years many still feel the same way. But more than that, many felt that the DB would remove the need for 'word-of-mouth' networking which is a critical part of field work. These concerns have proved to be groundless as ***the DB is just one tool available to field agents and can only be effective if used in conjunction with networking. Within an area it is still critical to obtain the dominant operator's views on problem cases and to calculate compensation using the fundamentals in order to determine important benchmarks.***

Sadly, the reality of current field work is that the precedent setting exception deals always trump the 'going' rates and they also trump any empirical analysis built up from the fundamentals. ***The land agent is miles ahead if he is aware of these bad deals before he visits the landowner. That way, he can be prepared with counter arguments*** showing why these deals are an exception and the amounts paid are not valid in all circumstances. However, if he doesn't even know the extent of the problems he can't be expected to adequately address them. Further, there is a great variation in factors even in a relatively homogeneous region due to differences in well locations and impacts on the landowner. The land agent needs to understand these differences from the 'going rates' if he is to be effective establishing fair compensation.

The main benefit of the DB to the field agent remains: fast, cheap, accessible, detailed, comprehensive, and objective information from which the agent can devise a unique strategy to approach the landowner.

What's wrong with the Field Tool DB

It seems that people either love the DB or they hate it. Over the past several years those who love it have averaged over 2000 searches per year. Searches bottomed in 2008 and have been increasing in 2009 and 2010. This is due primarily to an increased usage to research information in support of rent reviews. Those who love it treat it as one tool in the tool box. When it works it is the superior way to obtain information on going rates, comparable details, extra payments and bad deals. When data is thin then the agent can fall back on the less efficient but also effective 'word-of-mouth'.

Those who hate it claim it is an actual detriment to effective field research. However, many of the charges against the DB are based on misinformation or an outdated view of the DB. What is confusing is that those who voice concerns with the DB, agree with the objectives and the

underlying principles, and yet their vocalization of concern works to undermine the use of the DB as one tool amongst many. It is especially frustrating that the detractors seem incapable of making suggestions on how to solve their concerns.

The purpose of the review is to fully enumerate and describe in detail all the problems with the DB. Once a problem is fully described then it will be determined if the concern is a valid one or not. For those valid concerns the review will hopefully suggest a number of alternatives to solve the problem. For those concerns that are unfounded a communication program will be undertaken to provide more information.

In no particular order the known complaints are as follows:

1. DB is 'not accurate' or 'not reliable',
2. DB has inadequate data coverage,
3. DB data is fraudulent or fake,
4. DB excludes 'extra' payments,
5. DB excludes 'bad' deals,
6. DB is not updated in 'real' time,
7. DB report not accepted as evidence at SRB,
8. No use to operator who exclusively uses brokers,
9. We set the prices in our areas,
10. DB is too much like communism,
11. Brokers fail to supply data,
12. Administrator doesn't do enough sales and marketing,
13. DB is in violation of the Competition Act,
14. Competing research methods are better,
15. Discourages networking,
16. Costs too much,
17. DB violates a sacred trust confidentiality,
18. DB lacks rigorous data control function,
19. We have our own DB and that is all we need,
20. Operators unsure if they want data in or not.

There are probably a lot more, please send them to Bill Marriott (bill@wdmarriott.com).

Industry Issues

The industry is facing numerous issues in regards to surface compensation and access. While the DB field tool may assist in solving some of them, the real value of the DB is in the data itself. Without an adequate understanding of what is actually happening in aggregate it is impossible to know what policy options are best or what the appropriate position to take in any government representations. The following is a list of the issues facing industry:

1. Ever increasing surface access costs in Alberta,
2. Migration of Alberta rates to Saskatchewan,
3. Review of the Surface Rights Acts (AB within the Land Use Framework review),
4. Representations by agricultural lobby eg. AAMDC claims payments decreasing,
5. Increasing effectiveness of advocates and surface rights groups,
6. Implications of the SRB Dispute Resolution process,
7. Formation of BC Farmers' Advocate Office,
8. Ongoing debate around Adverse Effect and rents on pipelines,
9. AB FAO to form its own compensation DB,
10. Increasingly contentious rent review process.