AGLA
Alberta Grazing Leaseholders Association

Briefing Notes for Meeting with Auditor General **July 27, 2015**

Thank-you for agreeing to meet with us on short notice to address the concerns we had with your report about grazing leases.

Rangelands in Alberta have developed under and because of a historical grazing and fire regime. Since buffalo are no longer available in the numbers of the past and are difficult to manage, and because fire also has serious drawbacks, Albertans benefit by having leaseholders to manage the replacement tool for these grasslands - cattle. We help ensure the long-term sustainability of the land and watershed. We also help protect animals and plants at risk where needed. Leaseholders are the day-to-day managers of these lands and the natural stewards. Because we have significant investments in these lands, we maintain and protect them so they can continue to be productive for our benefit as well as for all Albertans.

Grazing leases began in Alberta in some shape or form in 1881 and have survived as an instrument to protect these valuable grasslands and stimulate agriculture. Roughly 20% of Alberta's cowherd is dependant on these Crown Lands under Agricultural Disposition for some of their forage requirements annually. Grazing leases, coupled with deeded holdings, generally form an integral and complementary part of a farm or ranch unit. Simply put, they function better together as a unit rather than split apart.

The Sustainable Resource Development agrologists have developed processes that ensure the land is in good health. Our Code of Practice, although voluntary, was developed with SRD staff and industry to outline the best practices and expectations. There are performance measures laid out within it as well as within department health assessment documents. While these lay out the guidelines and expectations, it is understood that there can be examples that may not fit in some of the described boxes, so adaptive management is necessary to achieve goals in some cases.

Industry and the department have been working collaboratively on modernizing our rental/royalty rates to bring them more in line with other resource users like timber and oil & gas. This process was ready to be implemented in 2009, but was submarined politically by some northern producers who didn't want to pay more. The remainder of industry was on-side but Premier Stelmach chose to halt the process at the request of a couple MLAs. We re-started the process last summer and came to much the same outcome this past winter with nearly the same push back from the same bunch. It is our hope to move some changes through the legislature during the fall session that would see the provinces rental revenue more than double.

The Surface Rights Act (SRA) provides the framework, principles and appeal process for any oil & gas compensation in Alberta. Leaseholders are considered occupants under the SRA and as such, qualify for compensation payments based on loss of use, adverse affects, inconvenience and noise. Compensation is intended to cover damages to the occupants' interest. The SRA sets the same "heads of compensation" for any land in Alberta, but recognizes that there are components of private land compensation that are not applicable to lease land occupants (e.g. value of the land). Once criteria that would impact only the owner of the land is removed, occupants on lease land end up typically receiving half the amount of compensation that a private land owner would receive. These payments are negotiated directly between the leaseholder and the oil & gas companies within the framework of the SRA. Some would argue that the Crown as the landowner should capture a greater share of the compensation currently going to the leaseholder, however the SRA contemplates compensation to the parties directly affected. It would be difficult for the Province to argue they are directly affected by noise, dust, change in farming practices, loss of use or nuisance.

Lets get to the issues directly in the report that we think need addressing and changing.

Firstly, grazing leases should always be referred to as Crown land under agricultural disposition, rather than Public Lands. While these Crown Lands are multi-use, they do have an agricultural priority, which is much different than the bulk of Public Land in the green zone of the province.

Secondly, we contend that the department is doing a good job in laying out objectives along with performance measures. The science of range management does not lend itself easily to defined targets. The big picture is the health of the resource that sustains benefits for Albertans as well as supporting the industry that manages this resource. We would suggest that the economic benefits to both the Province and industry, coupled with the environmental goods and services provided because of the healthy vibrant rangeland, means the objectives are being met. There should be no need to overlay more bureaucracy or regulatory control on top of what already exists. This added regulation is neither needed nor is practical.

Thirdly, the comments regarding concern about the use of a grazing lease as collateral or security doesn't reflect reality. Because CRA views a lease as real property, we are able to depreciate it over the life of the lease. This is common practice on any lease of any commodity or asset. So is the ability to sell the rights to the lease common in the lease world. Oil & gas companies do it all the time with mineral leases. A lease is taken on with the expectation of being able to make a profit, therefore one is willing to pay an acquisition fee for it, that in turn is capitalized into the lease cost along with improvements. Those are some of the factors that determine the cost of acquisition.

Fourthly, there needs to be an understanding of why Bill 31 was not proclaimed. It became a huge embarrassment for the Government of Alberta when they had to go and defend the reckless and unfounded claims of $40 million in industrial compensation in front of a tribunal for a 332 investigation in Washington D.C. They quickly retracted that exaggeration that came from the same erroneous extrapolation process your report used. Once we analyzed the impacts and unintended consequences of withdrawing the industrial acreages from the leases and pointed them out to the naïve authors of Bill 31, it was quickly set on the shelf and the potential of the deterioration of the relationship between oil & gas and agriculture was avoided. Little thought was given to the bureaucratic nightmare and mountain of paperwork that would be required to withdraw the industrial components, redo and reissue the leases, as well as fence them out with thousands of miles of fence, disrupting livestock watering and farming practices. The point men of Bill 31 disappeared into the woodwork; one bureaucrat resigned due to stress & ill health and the MLA retired after smearing his reputation with the agricultural community.

Fifthly, your contention that Alberta brings in only $4 million in rental compared to Saskatchewan at $9 is likely accurate, but ignores the fact that we would be bringing in more than Saskatchewan if we had passed the royalty review in 2009. Then you go on to throw in oil and gas revenue into the Saskatchewan pot, bringing it up to $20 million while leaving Alberta at $4 million, as if there was no oil & gas revenue coming to the province from these lands. The comparison is extremely skewed.

Sixthly, in your discussion on rental rates, you acknowledge that the department and industry have done lease costs studies that have indicated total costs of operating on lease is very comparable to private rentals, then you go on to say that our rental costs are a fraction of what private rentals are. We find this misleading and inflammatory.

When these issues are compounded together in a report that was released without consulting for some background on why things have progressed as they have, a great deal of unnecessary controversy erupted for all involved. It’s time to publicly set the record straight and restore the reputation of the OAG.

Response To Auditor General Report – Systems Audit of **Grazing** Leases Alberta

This report is based on information and data gleaned from records, interviews and discussions which, from our point of view, were in some instances accurate but in others incomplete and in still others inaccurate. The report makes assumptions and inferences which are not substantiated.

Beginning with page 15 of the report, our concerns are as follows:

1. "The province receives about $4 million annually from these leases."
    - This figure is an accurate estimate of the annual rental received from grazing leases but totally ignores the assignment fees collected by the province when grazing lease contracts are transferred (the grazing lease contract is renewable and assignable). Assignment fees vary from year to year but average about $1 million annually. The province also collects per acre access fees from industrial operators granted surface leases on crown lands under grazing dispositions.
2. "Grazing leases are intended for leaseholders to graze livestock on public land."
    - This statement is correct but incomplete. Grazing leases were initially instituted for a number of reasons, probably the least of which was to allow grazing of livestock on public land. Some of the reasons were to establish occupancy and demonstrate Canadian sovereignty as western North America evolved from wilderness to frontier to settled / populated areas. Initial leases were sold to entrepreneurs with rights to grazing coupled to requirements to stock, manage, and occupy the grasslands. Those rights and responsibilities of leaseholders have evolved over the years but still represent a much more bilateral benefit and complex relationship than the above statement infers.
3. "Albertans benefit by having leaseholders who help ensure long-term sustainability of the land and protect animals and plants at risk where needed."
    - This statement is also incomplete. Grasslands evolved under grazing pressure with the grazing managed by predators and aboriginal hunters. Leaseholders supply not only the grazing animals but also the infrastructure, management, and labor to accomplish managed grazing. They are required to graze the lands in the contract. There is a considerable body of scientific evidence to demonstrate that un-grazed grasslands deteriorate in terms of biodiversity and important ecosystem functions such as water capture and carbon sequestration.
4. "However, the department cannot demonstrate that the grazing lease program is meeting defined objectives."
    - This statement fails to identify whether there is failure to meet currently defined objectives, or whether the problem is the absence of defined objectives, or metrics to demonstrate achievement of those objectives. Later paragraphs and the recommendation found in the body of the report suggest the latter but ambiguous statements such as that quoted have no place in an OAG report.
5. "Further, current legislation allows an unquantified amount of personal financial benefit to some leaseholders over and above the benefits of grazing livestock on public land."
    - Does Alberta have any legislation which limits the amount of personal financial benefit achieved by investment, management, and labor in either the private marketplace or in statutory consents? Mineral leases and the activity related to finding, developing, and extracting that non-renewable public asset form a large part of the Alberta economy with considerable personal financial benefit accruing to everyone from shareholders (often non-resident) in the companies holding the leases to CEOs (bonus packages, etc.) both on the operation of those leases and on their sale / transfer to other entities. There are numerous examples of private investment of capital, management, and labor into acquiring and developing statutory consents involving public assets with potential profits (and losses) from operating and / or selling the disposition. Those examples include timber allocations, mineral

leases, and professional outfitters with allocations of tags they sell to non-resident hunters, or upon retirement to other outfitters.

- The department explained the compensation for damages, nuisance, inconvenience, and adverse effect payable to the occupant under the *Surface Rights Act* to the OAG. The requirement to appropriately graze the lease in spite of the management difficulties imposed by "operators" activities on the Crown Lands under grazing disposition may well result in fair compensation payable in excess of annual rents. The apparent alternative would be to remove the grazing and have industrial wastelands scattered throughout the grasslands of the province, with the associated deterioration of the entire area instead of just the operators' surface lease areas and the associated edge effect.

6. "We found unproclaimed legislation, Bill 31, from 1999 that would have allowed the province to collect a portion of the surface compensation fees from industry operators that are currently paid to leaseholders."
    - While it is true that Bill 31 (1999) passed the legislative assembly in 1999 and was never proclaimed, this statement fails to recognize that Bill 16 (2003) repealed almost all of Bill 31 and in particular repealed the provisions (79.1 and 79.2) which would have removed the industrial or other disposition lands from the agricultural disposition.
    - Bill 31, if proclaimed, would not "have allowed the province to collect a portion of the surface compensation fees from industry operators that are currently paid to leaseholders." Rather it would have required the Minister to remove the lands from the agricultural disposition whenever the Minister issued a new disposition for industrial or commercial purposes or for provincial or municipal infrastructure purposes where the lands were the subject of an agricultural disposition. Pipelines and exploration dispositions were exceptions to the withdrawal clause. Existing industrial or commercial dispositions would have been removed from the lands under agricultural disposition on the tenth anniversary of the coming into force of these sections of Bill 31. The province would not be eligible for **compensation** under the Surface Rights Act and so made no attempt to collect that under the legislation. Instead the Minister under section 9.01 would prescribe the rent payable to the Crown for the land removed from the agricultural disposition and now the subject of dispositions for industrial or commercial purposes or for provincial or municipal infrastructure purposes. Because the land was removed from the agricultural disposition, there would have been no compensation payable to the original agricultural leaseholder under the Surface Rights Act, section 26.1 as outlined in Bill 31 79.2(4)(a). The legislation did include a clause making the other disposition holder liable to pay the agricultural disposition holder for damages resulting from operations of the industrial / commercial / infrastructure disposition, but this process would have apparently been left to civil courts if agreement could not be reached as there was no provision for dispute settlement in Bill 31 . The Act was careful to ensure that no compensation was payable to the agricultural disposition holder for the land removed from the agricultural disposition.
    - The logistics of surveying, fencing, and legally amending agricultural dispositions would have been overwhelming and would have had a severely negative impact on livestock distribution on the remaining agricultural disposition.
    - Bill 31 was not proclaimed because the Legislative Assembly of Alberta reconsidered their decision and chose to pass different legislation amending agricultural dispositions statutes (Bill 16, 2003) and this legislation (Agricultural Statutes Dispositions Act 2004) was proclaimed and has come into force. Thus at the time of writing of the OAG report there was no unproclaimed legislation "that would have allowed the province to collect a portion of the surface compensation fees from industry operators that are currently paid to leaseholders."

7. "The department requires leaseholders to keep the land under lease in good health and to keep other requirements such as fencing, record keeping, and taxes in good shape and up to date. Other than these requirements…"
    - One of the primary requirements of the department is to utilize the lease with certain species of grazing animals and at the capacity specified by the department.
    - While it is the land that is under lease it is the associated ecosystem which must be kept in good health.
8. "Public land is set aside for the benefit of all Albertans,"
    - Crown Lands under agricultural or grazing lease disposition have not been set aside. In the beginning all lands were public lands. The governments of the day make decisions regarding the use of those lands as well as the legal instrument to achieve that use. Renewable, assignable grazing lease contracts are one of those instruments. Homesteads were another instrument, with title to the land transferring to the homesteader on completion of the requirements of the homestead agreement. One recent allocation of public land in the province saw the city of Fort McMurray obtain additional lands under freehold interest to allow for growth. It is misleading to infer that grazing lease lands were "set aside for the benefit of all Albertans,".
9. "Initially, grazing leases were a way to allocate public land for use by settlers and ranchers. Over the years, the rationale for grazing leases has changed from land allocation to goals such as supporting agriculture in Alberta, provision of ecological goods and services to all Albertans and ensuring that Albertans use public land in an environmentally sustainable way."
    - As mentioned previously there were many more reasons for issuing grazing leases than to allocate land for settlers and ranchers. It would be more accurate to describe supporting agriculture and provision of EGS as potentially unintended benefits of issuing grazing leases rather than rationale for them. In terms of ensuring that Albertans use public lands in an environmentally sustainable way - that would be a difficult argument in the case of Fort McMurray's acquisition of public lands. However it has been another benefit of the grazing lease system.
10. "Leaseholders pay rent to the province based on a formula to calculate Animal Units per Month (AUM)."

    - Leaseholders pay rent to the province at a rate determined by the Minister, as per Section 103 of the *Public Lands Act* (see below). That rent is partially based on a formula to determine forage value, but is definitely not based on a formula to calculate Animal Units per Month.

103**(1)** The rent payable under a grazing lease is

(a) an annual rent equal to the percentage established by the Lieutenant Governor in Council of the forage value of the leased land, and

(b) any additional annual rent prescribed by the Minister.

- The department does use a formula to determine the forage value, but not to calculate the Animal Units per Month.
- The Minister by virtue of section 103(1)(b) ultimately determines the rental rate.

11. "The formula in the *Public Lands Act* to set rental rates was developed in the 1960s and the rental rates per AUM have been frozen since 1994."
    - The formula (included in the appendix to the report) is not in the *Public Lands Act*.
    - Rental rates have been frozen since 1994 but it is important to recognize that in several of the years in the period since 1994 the rental rate would have been lower than the frozen rate had the tradition of using the formula with no additional rental as prescribed by the Minister been followed.

12. "Grazing leases generate revenue to the province through annual rental fees and lease transfer or assignment fees. In 2013 – 2014 the province collected $3.8 million dollars from grazing leases."
    - While the statement recognizes two sources of revenue from grazing leases the $3.8 million reflects only one of those sources (the annual rental). Assignment fees average approximately $1 million annually.
13. "Bill 31 was passed in 1999 but never proclaimed into law."
    - See earlier comments regarding Bill 31. All of the sections of the Bill that would have allowed the departmental actions detailed in the report were repealed by Bill 16 in 2003. It is inappropriate for the auditor general to comment on repealed legislation.
14. "The Department of Environment and Parks should have effective systems to identify leaseholders who receive revenue from oil and gas exploration and extraction or the sale of their leases and ensure leaseholders are not deriving personal benefit from Alberta public assets beyond uses the assets are intended to provide."
    - Compensation for loss of use, nuisance, inconvenience, and adverse effect is exactly that and is due to the occupant / operator of the agricultural disposition on which the industrial disposition is superimposed. These payments are not for access, as is inferred multiple times in the OAG report. Bill 31 recognized that these industrial activities have negative impacts on the grazing leaseholder and as such included the requirement for operators to pay damages to the agricultural disposition holder. Further, Bill 31 recognized that the province was not eligible for this compensation and therefore included the clause allowing the Minister to prescribe annual rental for the industrial dispositions. Of course, all of this is moot given that those sections of Bill 31 were repealed in 2003. It would seem important for the department to know the number and location of industrial dispositions superimposed on grazing dispositions. They have the information required to achieve this.
    - Grazing leaseholders who sell their renewable, assignable grazing lease contract are selling the private property contract – not the lease land itself. Thus the department need not worry about personal benefit from public assets beyond the use the asset was intended to provide. The department already knows when grazing leases transfer as they must approve the transfer and complete the paperwork, as well as collect the assignment fees. We are not sure whether they track the number of transfers per year but from the perspective of health of the grazing ecosystem fewer transfers are desirable as long term tenure and security of tenure is fundamental to incenting and achieving high level stewardship.
15. "The province charges less rent for grazing leases than private landowners charge."
    - The report has previously identified that there are basic differences in the costs incurred to operate grazing leases than those incurred in private rental agreements (fencing, water development, municipal property taxes) but then goes on to make this misleading statement. Previous studies and models conducted by third parties have consistently demonstrated that once additional costs of operating grazing leases are factored in to the equation the costs are comparable with private rental agreements. Without those adjustments to the grazing lease rent this is an apples / oranges comparison.
16. "Leaseholders are entitled to compensation for disruptions or damage from industrial operators in the form of surface access fees. Although the land belongs to all Albertans, the *Surface Rights Act* requires industry operators to pay leaseholders for surface access to their grazing leases."
    - As mentioned previously, compensation for industrial dispositions superimposed on lands under agricultural disposition is not for access, but rather for loss of use, adverse effect, nuisance and inconvenience. The *Surface Rights Act* does not require industry operators to pay leaseholders for access. In fact it allows access in the absence of agreement on compensation with a binding disputes settlement mechanism. The province currently does collect an access fee from industry operators on public land. It is typically lower than the access fee per acre negotiated by private landowners.

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17. "If those amounts were consistent throughout the province, Albertans would be foregoing over $25 million in access fees currently paid to leaseholders."
    - Even Bill 31 recognized that the province would not be eligible for the compensation directed to occupants under the *Surface Rights Act,* so Albertans are not foregoing any of these dollars.
    - There is no assurance that the industrial activity or the resulting compensation reported by grazing associations is consistent throughout the province. In fact, both grazing associations and industrial activity tend to be clustered, which further skews the numbers used.
18. "In our audit we found that leaseholders can use grazing leases to obtain a mortgage or as collateral on loans. We also found that leaseholders can sell or transfer a lease and they keep the entire amount for which the lease is sold. By law, mortgages and the sale of grazing leases are private matters;"
    - Leaseholders are required to pay assignment fees before grazing leases are transferred – thus they do not keep the entire amount for which the lease is sold. The assignment fee in Zone A2 is $100 per AUM so these fees are significant and in fact add up to about $1 million revenue annually for the province.
    - The collateral / mortgage aspect of grazing leases is based on the disposition itself (the private lease contract) and not on the Crown land under disposition.
    - Since the OAG recognizes that sale of grazing leases is a private matter it is inappropriate to have the extensive discussion regarding the sale of grazing leases in a systems audit of the grazing lease system.
19. "In one example we found two grazing leases on public land that were listed for sale together in southwest Alberta. The leases had a total of 1,134 acres and 257 AUMs. The yearly rent paid to the province was $486."
    - The OAG has apparently accepted the details of a realty listing without doing any due diligence. The Appendix to the report clearly indicates the rental rates in each of the three zones in the province. 257 AUMs in Zone A (southwest Alberta) would have an annual rental of $717.03. In Zone B (central Alberta) those same AUMs would engender annual rental of $596.24. In Zone C (northern Alberta) the annual rental for 257 AUMs would be $357.23. In fact the only way the annual rental for two grazing leases with a total of 257 AUMs would be for the two grazing leases to be in different zones with one of the leases in Zone C.
20. "The current leaseholder will keep the total amount for which the leases are sold."
    - If indeed the two leases are in southwestern Alberta (Zone A2) and the grazing capacity is 257 AUMs, the province will receive $25,700 in assignment fees - *Public Lands Act* section 114.1(1)(b). This may be paid by the vendor or the purchaser or some combination thereof but it will certainly be paid by a leaseholder and before the lease is transferred.
21. "A survey by the Department of Agriculture in 2012 showed that privately owned land in Alberta rented for $20.00 to $30.50 per AUM. This is more than 10 times the $1.39 to $2.79 per AUM the department currently charges for grazing leases throughout Alberta (see appendix)".
    - The report acknowledges the differences in private rentals and provincial grazing leases but the OAG cannot refrain from commenting and making inappropriate direct comparisons (more than 10 times higher). The assignment fees mentioned in the previous point are infinitely higher than the same fee in all private rentals we are aware of. Amortized over ten years the assignment fee adds $10.00 per AUM to the "rent" of the grazing lease. Four percent interest or opportunity cost on the assignment fee adds an additional $4.00 per AUM to the "rent". Municipal taxes are likely to add at least as much as the annual rent collected by the department. Once the leaseholder has paid these fees, taxes and interest they then proceed to fence the lease, develop water sources and provide the other livestock handling infrastructure typically included in private rental arrangements as reviewed by the department of Agriculture.

- Previous studies and models conducted by third parties have consistently demonstrated that once additional costs of operating grazing leases are factored in to the equation the costs are comparable with private rental agreements. Assignment fees have never been included in the grazing lease cost studies so they would substantially add to the cost of operating a grazing lease as compared to a private rental arrangement. Without those adjustments to the grazing lease rent this is an apples / oranges comparison.

22. "However, the code itself is not mandatory." (regarding Grazing Lease Code of Practice)
    - Compliance with the code is not mandatory but compliance with the Recreational Access Regulation is.
    - Failure to comply with stocking rates and grazing practices prescribed by the department can result in reductions to carrying capacity or limitations on usage of the grazing lease, and in extreme cases cancellation of the lease.
23. "We confirmed that, other than requiring leaseholders to keep their leases in good health, pay rental fees and taxes, and allow recreational access, the department has not defined any other objectives for grazing leases."
    - Appropriately utilizing the lease with appropriate species of grazing animals and fencing the lease are requirements.
    - Taxes include both municipal property taxes and assignment fees.
    - Keeping leases in good health and allowing both recreational access and industrial access is no small task. It requires an immense amount of on-site management.
24. "The new system and rental rates were developed so that there is a minimum annual rent and then a variable "sliding or dynamic rate" that increases as cattle prices rise."
    - The proposed new system does have a minimum rate and a dynamic component but the dynamic component is based on profitability of operating the grazing lease, not simply the price of cattle. Price of cattle is one component of the profitability but is a severe oversimplification of the royalty / rental scheme proposed. In fact it is possible that rentals would increase when cattle prices are dropping if light weight classes of cattle dropped in price more than heavier cattle.
25. "We realize that we cannot directly compare the revenue Alberta and Saskatchewan receive from leases on public land. However, from each province's financial statements, we can confirm Saskatchewan collects over $20 million compared to Alberta's $4 million."
    - The OAG realizes they cannot directly compare these revenues but then that is exactly what they do - $20 million compared to $4 million.
    - The $4 million figure for Alberta ignores assignment fees and surface access fees for industrial dispositions collected in Alberta.
    - This is another example of an apples / oranges comparison. The report might as well have reported the comparable potash or bitumen revenues of the two provinces. They are different provinces with different regulations, legislation, policies, and objectives.