LANDOWNER OIL & GAS LEASING WORKSHOP

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Background/Goals

- My experience
  - Negotiated with oil and gas companies in Colorado
  - Managed land for landowners
- Goal: Landowners learn from other landowner experiences
- Goal: Landowners learn their options
- Goal: Make informed/confident decisions

My Presentation

- ACTUAL EXPERIENCES OF OTHER LANDOWNERS
- What landowners are doing in other areas of the country

What Happened?

- Petoskey Expl. drilled Pioneer 1-3 for Encana. Vertical to 9685 feet horizontal to 15,001 ft into Collingwood shale – Utica overlies Collingwood
- Tested @ 2.5 million cu ft/day gas/ condensate/natural gas liquids
- Encana leased 250,000 acres @ $150/acre last 2 years – 7 year leases
- Utica producing 10 mil cu ft/day in Canada

PSYCHOLOGY of LEASING

Key Participants in Leasing:

- Landowner = negotiator = price maker not taker
- Land man = paid by and loyalty to oil company, experienced

Psychology of Leasing (cont.)

Negotiating Points:

- Everything is negotiable
  - * Use Dogged Determination

- Know what you want, be firm
- May not arrive on an agreement – OK
- Good leases take time and last a long time
- Let the games begin! – Use a scapegoat
- Seek attorneys advice

Types of Oil/Gas Leases

- Oil and Gas Lease
- Oil and Gas Lease (Paid up)
  - Delay rentals for primary term are included with bonus
- Oil and Gas Lease (No Surface Use)
  - Also called Non Development Lease
  - No surface disturbance or structures

Landowner Assns

- Common in Western United States for Wind Farms
- Three Types
  - Landowner Info Sharing Group – no lease marketing
  - Landowner Coalition – markets contiguous acres, but not binding on members
  - Landowner Bargaining Unit – members must accept lease terms agreed to by majority

Lease Terms

- Granting Clause states purpose of lease
  - "sole and only purpose ….drilling and operating for oil and/or gas"
  - Because: market rate for helium, gravel, other minerals may be different
- Signing an oil and gas lease "sells" part of property
- Can lease specific geologic formations

Lease Terms Cont.

- Pipelines, roads allowed – grant unpaid easement?

Lease Terms

- Primary term: 3-5 yrs.
- "Warranty of Title" language: delete or alter
- Require performance bond (letter of credit) to cover costs of owner if lessee breaches lease, assures restoration, clean-up – State of MI does
- Performance bond is a surety issued by insurance company or bank to guarantee satisfactory completion of project by contractor

Lease Terms (cont.)

- Record actual lease at register of deeds not memorandum of lease
- Allow brine disposal wells?
- Allow central production facilities?
- Noise suppression
- Get verbal promises in writing
- Company deadlines come and go – no hurry

Lease Terms cont.

- Provide means to settle disputes such as mediation or arbitration
- Pugh clause: All lands not receiving royalty from any unit or pool after primary term shall be considered un-leased and returned to full control of Lessor
- Lease specific strata

Shut-In Terms

- Well capable of producing but markets or other reasons prevent sales
- Negotiated - owners have received annual payments equal to bonus rate/acre
- Can escalate each year
- Shut – in payments not continue more than 3 years
- If payments not made or stop – lease terminates

Lease Terms (cont.)

- Non-development areas: identify areas exploration not allowed.; example: distance from existing buildings
- Be comfortable with every paragraph before signing
- Take photos before Lessee's operation begins

Airport Runway Wells

Lease Terms Royalty

- Royalty Terms
  - 1/8 (12.5%) federal government
  - 1/6 (16.7%) State of MI
  - 3/16 (18.8%) to 25% private leases

  Gross proceeds of Oil and gas (including all substances contained in such gas) produced from the leased premises in marketable condition at no cost to lessor

Royalty Continued

Lessee bear exploration, production, post production and marketing costs.

Lessor not charged for gathering, compression, treatment, dehydration expenses before royalty calculated

- Bonus: Paid at lease signing;
  - $0 to $5,000/acre; ROYALTY AND LEASE MORE IMPORTANT

Post Production Costs

- 324.61503b: "A person who enters into a gas lease as a lessee after 3-28-2000 shall not deduct from the lessor's royalty any portion of post production costs unless the lease explicitly provides for the deduction of post production costs."
- Costs allowed if in lease: Removal of C02, N2, H2S, transport into non-affiliated pipeline system and others

Magnitude of The Royalty

- Situation: 40 acres, one gas well @ .5MMcfe(500,000cu.ft/day) @$4.00/Mcfe(thousand cu. ft.) = $2,000/day (assumes decline in production from day 1)
- 1/8 royalty = $27,375/yr = $684/acre/yr
- 1/6 royalty = $36,573/yr = $914/acre/yr
- 3/16 royalty = $41,172/yr = $1,029/acre/yr
- .20 royalty = $43,800/yr = $1,095/acre/yr

Royalty Continued

- Marcellus Shale in Pennsylvania
  - Early leases 1/8 (12.5%)
  - Land leased recently 20%
  - No post production costs except any to enhance market value
  - Bonus up to $6,000/acre currently
  - Many small landowners
  - Wells up to 9000 feet deep

Royalty Continued

- Barnett Shale in Central Texas
  - 20 to 25% royalty
  - Few or no post production costs
- Wells 9,500 to 15,000 feet deep
- Barnett lies beneath Dallas/Ft. Worth cities
- Many leases < 1 acre
- Gas only
- Chesapeake and Total leases reviewed

33 Wells Greeley, Colorado

Surface Use & Surface Damage Agreements (Addendums)

Usually a separate agreement, but required in the lease

State of Michigan lease requires a "Surface Use Permit for Well Site"

A separate agreement that:

- Occurs when drilling is planned but before commencing

Surface Use & Surface Damage Agreements (cont.)

- Lease can state:

  "No operations shall be conducted by the Lessee until a separate Surface Use Agreement is agreed to and signed by Lessor and Lessee."

Surface Use & Surface Damage Agreements (cont.)

- Encourages lessee to limit surface disturbance.
- Lessor's input to reduce impact on surface uses
- Lessee provides proposed development plan and map that shows proposed access route.

Surface Use & Surface Damage Agreements (cont.)

- Location of well, separator, tanks, existing pipelines and flow lines to be installed. Can be nearest public road
- Requires payment for all damages to surface including loss of use of damaged surface.
- Requires restoration of exposed areas.

Surface Use & Surface Damage Agreements (cont.)

- Lessee pays all damages caused by all operations under the lease.
- Can require a performance bond, cash bond, letter of credit from lessee – State of MI does
- Can require that fence be installed around drilling site. Fence posts to mark road boundary

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RIGHT OF WAYS (ROW)

- ✓ Definition: Right to use or travel over someone else's land and have reasonable use and enjoyment of that right as long as not inconsistent with owner's use and enjoyment of the land.
- ✓ Used for roads, pipelines, power lines, phone lines, etc.
- ✓ Flow line from well to separator and tanks = no ROW required

Rights of Ways (ROW) cont.

- ✓ If pipeline contains material from wells other than yours = ROW required
- ✓ Landowner not legally required to grant a ROW unless a FERC project - NEGOTIATE
- ✓ It should have a metes and bounds legal description and plat attached
- ✓ It should be for a minimum term (no greater than 30 years) Not a perpetual easement

Rights of Ways (ROW) cont.

- Legal Considerations Continued
  - Should clearly state the purpose. For example allows for one pipeline not "pipelines"
  - Pipeline buried to 48" not "below plow depth "
  - Separate topsoil from subsoil and place back in trench in same order
- Restoration bond, letter of credit to insure surface restoration and all damages repaired: 1-5% cost

Rights of Ways (ROW) cont.

The payment can increase based on size of pipeline, i.e. a 6" line should pay more than a 4" line

- Compensation :
  - Paid in advance one time on a per foot or per rod basis
  - Should be at least the market value of the land
  - $2-5 per foot for a oil and gas sales line not uncommon

Rights of Ways (ROW) cont.

Compensation continued:

- Additional compensation for damage to land, crops, fences, timber
- Grantee to reclaim damaged areas at his expense
- Grantor (landowner) to approve reclamation plan

Rights of Ways (ROW) cont.

- Compensation continued:
  - For pipeline ROW additional compensation to Grantor for above ground valves, pig launchers, meters
- Legal Considerations
  - Document should be "Grant of Right of Way" not "Easement"
  - Firm expiration date
  - Should be recorded at county offices

Rights of Ways (ROW) cont.

- Legal Considerations Continued
  - Should be non-exclusive so rights of ways can overlap
  - Keep width as narrow as possible- pipeline ROW 30 feet wide commonly
  - Metes and bounds legal description with attached plat indicating planned structures and existing structures
  - Legal description on plat and document should match

TAKE HOME MESSAGE

- DO YOUR HOMEWORK
- PUT ON YOUR NEGOTIATOR HAT
- GET INFORMATION AND ASK QUESTIONS

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QUESTIONS?