OIL & GAS ISSUES IN THE COLLINGWOOD SHALE

MSU EXTENSION
June 2010

SUSAN HLYWA TOPP
TOPP LAW, PLC

OIL & GAS LAW BASICS

- Oil and gas mineral interests are part of the realty until the time that they are severed;
- The ownership of the mineral interests can be severed from the ownership of the surface estate;
- The severance of mineral interests from the remainder of the land may be effectuated by a reservation or exception in deed;
- Upon the severance of title to the mineral interest from the remaining land, the mineral estate and the surface estate each become freehold estates in fee simple and are subject to laws of dissent, devise, and conveyance;

Copyright 2010 Topp Law PLC

OIL & GAS BASICS CONT.

- The owner of the severed mineral interests may lease the interests;
- Under an oil and gas lease, the lessee acquires the right to use and occupy that portion of the surface of the land that is needed for the exploration of oil and gas; and
- The owner of the surface estate has an implied duty to allow the owners of the mineral estate to exercise their rights to extract oil and gas.

Copyright 2010 Topp Law PLC

MINERAL ESTATE IS DOMINANT

- MINERAL RIGHTS ARE AN INTEREST IN REAL PROPERTY THAT CAN BE OWNED SEPERATELY FROM THE SURFACE.
  - When the minerals are severed from the surface, two separate estates exist: the surface estate and the mineral estate.
  - When the mineral estate is severed from the surface, the mineral estate is the dominant estate and the surface estate is the servient estate.
  - The owner of the mineral estate can make “reasonable use” of the surface estate that is necessary for the development of the minerals.

Copyright 2010 Topp Law PLC

DORMANT MINERAL STATUTE

- Michigan Dormant Mineral Act, MCL 554.291 et seq
  - Any interest in oil or gas in any land owned by any person other than the surface owner that has not been sold, leased, mortgaged, or transferred by an instrument recorded in the office of the register of deeds for 20 years is deemed abandoned if
    - 1) a drilling permit is not obtained;
    - 2) actual production is not obtained from the property or pooled unit;
    - 3) interest not used for underground gas storage.

Copyright 2010 Topp Law PLC

REGULATION OF OIL AND GAS DEVELOPMENT

- PART 615, NATURAL RESOURCES AND ENVIRONMENTAL PROTECTION ACT, MCL 324.61501 ET SEQ. (SUPERVISOR OF WELLS ACT)
  - Administrative Rules MAC 324.101-324.1301
  - Administered by Geological Survey Division, even when there is contamination from a release.

Copyright 2010 Topp Law PLC

WHAT IS THE EFFECT OF A SEVERED MINERAL ESTATE?

- RISK OF FUTURE MINERAL DEVELOPMENT ON THE SURFACE.
  - Mineral owner can drill wells, build roads, lay pipelines, and construct other facilities on the surface without obtaining the consent of the surface owner.
  - Surface owner not entitled to damages for diminution in value.
    - *See* Topp, *Severed Minerals: Are Surface Owners Entitled to Damages for Diminution of Their Property Value?* Vol.78, No. 2 Mich. B. J. 148 (Feb. 1999)
    - Court's logic is that it would be a windfall to the surface owner because they presumably paid less for the property.
  - Doctrine of "reasonable accommodation"
    - Customary uses in the industry
    - Surface owners intended use must be documented

Copyright 2010 Topp Law PLC

TITLE INSURANCE

- MINERAL RIGHTS ARE EXCEPTED
  - Title insurance companies except mineral rights and mineral conveyances from the title policy.
  - If you want verification of mineral ownership, a separate mineral title search must be obtained from a company who specializes in such searches.
  - The search results should be reviewed by an oil and gas attorney who will draft a mineral title opinion.

Copyright 2010 Topp Law PLC

DEEDS

- MINERALS ARE TRANSFERRED WITH THE SURFACE ESTATE UNLESS THEY ARE EXCEPTED AND RESERVED IN THE DEED.
  - If not carved out by Seller, Buyer gets what ever the Seller owned.
  - If the minerals were reserved to the Seller in the purchase agreement, but erroneously not retained in the Deed, the courts have reformed the Deed based upon the intent of the parties as reflected in the purchase agreement.

Copyright 2010 Topp Law PLC

MINERAL OWNERS

- The companies use “landmen” to solicit oil and gas leases from mineral owners.
- The lease forms are drafted for the benefit of the company, not to protect you
- There is much to be negotiated in the oil and gas lease to protect the interest of the mineral and property owner.

Copyright 2010 Topp Law PLC

WHO ARE THE PLAYERS?

- ENCANA
  - Leasing companies are Energy West or Coughlin Land or Mason Dixon
  - Canadian company with office in CO
- CHESAPEAKE ????
  - Leasing company is Western Land Services
  - OIL Niagaran

Copyright 2010 Topp Law PLC

- Core Energy
  - Leasing under Hidden Valley, Inc.
- Atlas
- Meridian
- Continental (out of play)
  - Leasing by Exterra

Copyright 2010 Topp Law PLC

WHAT IS THE COLLINGWOOD

- The Collingwood is a shale between 9,000 and 10,000 feet deep in the Utica formation, below the Niagaran and above the Trenton.
- Developed by horizontal drill. May have 5 to 8 wells on one drill pad.
- Anticipate the production unit to be 640 acres.

Copyright 2010 Topp Law PLC

THE OIL AND GAS LEASE

- This will set the stage for what the company can do and how they will do it on your property for the next 30 years.
- Look past the signing bonus – understand what the lease says and doesn't say
- Do not be pressured into signing – do not sign a lease you are not comfortable with
- Verbal promises do not count - EVER

Copyright 2010 Topp Law PLC

- Have your issues addressed in an addendum to make the lease work for you.
- A good lease is a win/win for you and the company, but you must fight for it.
- Do not sign a lease without having it reviewed by an oil and gas attorney first, it is a contract. We cannot help you after it is signed and the consideration is paid.

Copyright 2010 Topp Law PLC

GRANTING CLAUSE

- Lessor, for and in consideration of $, the receipt of which is hereby acknowledged, does hereby grant, lease and let unto Lessee the land described below, including all interests therein Lessor may acquire by operation of law, reversion or otherwise, (herein called "said land"), exclusively, for the purposes of exploring by geophysical and other methods, drilling, mining, operating for and producing oil and/or gas, **together with all rights, privileges and easements useful or convenient** in connection with the foregoing and in connection with treating, **storing**, caring for, transporting and removing oil and/or gas produced **from said land or any other land adjacent thereto**, including but not limited to rights to lay pipelines, build roads, drill, establish and utilize **wells and facilities for disposition of water, brine or other fluids**, and for enhanced production and recovery operations, and construct tanks, power and communication lines, pump and power stations, and other structures and facilities.

Copyright 2010 Topp Law PLC

- CAN USE SURFACE FOR OPERATIONS ON ADJOINING LAND
- INCLUDES RIGHT TO DRILL DISPOSAL WELLS
- STORAGE

Copyright 2010 Topp Law PLC

ROYALTY

- You only get paid a royalty if your land is included in a production unit
- Most leases offering 1/6
- Have seen some leases for 3/16
- Other states paying 1/5 for shale leases
- You must look at the total package you are getting

Copyright 2010 Topp Law PLC

TERM

- PRIMARY AND SECONDARY
  - MOST LEASES ON THIS PLAY 5/5
  - BONUS HAVE RANGED FROM $300 TO $2,000
  - BONUS FOR SECONDARY TERM SHOULD BE SAME AS PRIMARY TERM

Copyright 2010 Topp Law PLC

CONSULTATION AND DEVELOPMENT PLAN

- Lessee and Lessor shall mutually agree on the location of drill sites, tanks and necessary structures for production equipment, and the course, route and direction of roads and pipeline installations.
- The locations should be a minimum of 500 feet from any existing building unless the prior written consent of Lessor is obtained.
  - If you object to the proposed locations, propose an alternate location to Lessee.
- Do not make unreasonable requests of the Lessee.

Copyright 2010 Topp Law PLC

Non-Development

- Need 5 acres for these drill site pads, plus access road and pipeline
  - Been advised that road and pipeline needs to be 50 feet wide during construction
- Drill sites do not have to be precise location
- No reason why you cannot negotiate certain portions of your property as non-development areas

Copyright 2010 Topp Law PLC

DAMAGES

- Signing Bonus is consideration for granting of the lease, not compensation for damages
- Negotiate per acre damages for well pads, pipeline routes and access corridors that reflect fair market values

Copyright 2010 Topp Law PLC

INJECTION WELL/COMPRESSOR

- Should only be located with consent
  - Understanding is that will not be one at every drill site
  - Risk of trucking in brine from other wells
- Compressor Facilities
  - Have been advised these wells will need compression
  - Separately negotiate.

Copyright 2010 Topp Law PLC

MUD/BRINE PITS

- Used during drilling process for brine and fracing
- When well completed, will suction off liquids and bury the plastic liner in place
- Limit use to well on your property only to prevent trucking of brine

Copyright 2010 Topp Law PLC

Post Production Costs

- Some companies not charging any
- Encana Lease says “all PPC’s from well head to point of sale”
- OIL and other leases enumerates specific PPCs then includes all PPC’s in catch all phrase.
- Statutory limits
- Negotiate these.

Copyright 2010 Topp Law PLC

WATER PROTECTION

- Good idea to sample your own water
- Require water protection clause that includes provision of alternate water supply if contaminated
- Require that the Lessee notify you of any spills of contaminates on the property

Copyright 2010 Topp Law PLC

TIMBER

- Specify how timber will be handled, you want to have the option to remove yourself
- Cut in sawlog lenths/8 foot lengths for pulpwood
- Have your forester value the timber before it is cut

Copyright 2010 Topp Law PLC

Compulsory Pooling

- Company can petition the Supervisor of Wellls to force pool your land if you do not agree to lease
- Cannot use your surface!!
- Treated as a working interest owner or investor and get a royalty free of post production costs
- Even with the penalty, not a bad way to go if cannot negotiate a good lease.

Copyright 2010 Topp Law PLC

THINK IT THROUGH

- Consider the way you currently use your property and how you might use it in the future
- Consider preservation of pastures and fencing of pipelines to prevent injury
- If the company really wants to lease you, the landman will work with you or your attorney to reach an accommodation.

Copyright 2010 Topp Law PLC

- IF IT ISN’T IN THE LEASE, IT NEVER HAPPENED.

Copyright 2010 Topp Law PLC

REFERENCES

- Topp, *Severed Minerals: Are Surface Owners Entitled to Damages for Diminution of Their Property Value?* Vol.78, No. 2 Mich. B. J. 148 (Feb. 1999)
- Topp, *Severed Minerals: Restrictive Covenants as Restrictions on Surface Use by the Mineral Owner,* Vol 32, No. 4 Michigan Real Property Review (Winter 2004)
- Topp, *Severed Minerals, Split Estates, Rights of Access, and Surface Use in Mineral Extraction Operations*, Rocky Mountain Mineral Law Foundation, February 17-18, 2005, Westminster, Colorado.

Copyright 2010 Topp Law PLC

CASE LAW

- *Jaenicke v Davidson*, 290 Mich 298; 287 NW 472 (1939)
- *Eadus v. Hunter*, 268 Mich 233; 256 NW 323 (1934)
- *VanSlooten v Larsen*, 410 Mich 21; 299 NW2d 704 (1980)
- *Craig v Bickle*, 455 US 901; 102 S Ct 1242; 71 L Ed 2d 440 (1982)
- *Southwestern Oil Co v Wolverine Gas and Oil Inc*, 181 Mich App 589 (1989)
- *Rathbun v State*, 284 Mich 521; 280 NW 35 (1938)
- *Stevens Mineral Co v State*, 164 Mich App 92 (1987)
- *VanAlstine v Swanson*, 164 Mich App 396 (1987)
- *Miller Bros v Dep't of Natural Resources*, 203 Mich App 674 (1994), app den 447 Mich 1038; 527 NW2d 513 (1994).
- *The Mabel Cleary Trust v The Edward Marlah Muzyl Trust, et al*, 262 Mich App 485, 686 N.W.2d 770 (2004)

Copyright 2010 Topp Law PLC

ABOUT THE SPEAKER

Susan Hlywa Topp is the owner and manager of Topp Law, PLC, which is a boutique firm in Gaylord, Michigan. She practices exclusively in the areas of environmental, oil & gas, natural resources, alternative energy, and real estate development law. Prior to starting her own practice, she was an Associate with Plunkett & Cooney and a partner in the law firm of Rolinski & Topp. She was also employed for 13 years as a Conservation Officer/Environmental Conservation Officer with the Michigan Departments of Natural Resources/Environmental Quality. Mrs. Topp is the Past Chair of the Environmental Law Section Council of the State Bar, Vice Chair of the Energy Committee of the Environmental Law Section, and an Adjunct Faculty Member of the Siena College – Audubon International Institute. She graduated magna cum laude from Central Michigan University in 1978 and received her law degree cum laude in 1991 from Wayne State University.

TOPP LAW PLC
213 East Main
Gaylord, MI 49735
989-731-4014
susan@topplaw.com

Copyright 2010 Topp Law PLC