WHAT A LANDOWNER NEEDS TO KNOW ABOUT OIL AND GAS LEASING (ENVIRONMENTAL ISSUES)

Ottawa County

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Environmental Protection Begins with the Oil and Gas Lease

- Tonight is our third meeting in Ottawa county; the first was held in Olive Township 11-1-2012

Environmental Protection Begins with the Oil and Gas Lease

- Groundwater protection: American Petroleum Institute established industry best practices (see MSUE oil and gas newsletter Sept. 2012)
  - Water protection not offered in “Standard” lease
  - Test before any drilling to establish baseline water quality
  - Test again soon after hydraulic fracturing
  - Test again approximately 6 months after fracturing

Environmental Protection Begins with the Oil and Gas Lease

- Some materials to test for: benzene, toluene, total petroleum hydrocarbons and others
- Use list of chemicals used for the fracturing as guide for what to test for


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11-1-13 DEQ Part 14 Proposed Draft Hydraulic Fracturing Rules

- Requires baseline water testing
- Benzene, toluene, methane, others
- Company provide results to DEQ, water well owners within 45 days of sampling
- Disclosure of hyd fracture chemical additives
- Use of water withdrawal assessment tool
- Sample water wells within ¼ mile O&G well

Proposed Hyd Fracturing Rules Continued

- Silent on who pays for tests
- Silent on procedure for post testing to document quality still at baseline

- Supervisors Instruction 1-2011 forerunner to new proposed rules
  - Required use of water assessment tool to prevent impacts to existing water users

Water Protection and the Lease

- Water protection can be put in lease:

...“if such tests reflect a material adverse change in the Lessor’s water quality or quantity, then it shall be presumed that the same was caused by the Lessee’s operations”

- May want to require company use accredited lab and not their own personnel to conduct test. Neither landowner or company should handle material
- MUST USE PROPER PROCEDURES AND ANALYSIS

What Should a Mineral Rights Owner Think About?

- The oil and gas lease = marketing plan for oil and gas mineral rights
- Mineral income can be substantial
- Don’t treat your minerals as second class citizens!
- How the lease terms affect me
- The lease is written by the company for the company

The “Standard” Lease Allows the Following Unless Mineral Owner Negotiates

- Pipelines above plow depth
- Damages to growing crops only
  - Drainage tile?
  - Roadways?
  - Drilling sites?
  - No mention of water quantity or quality
- Oil and gas well within 200 feet of bldgs
- No topsoil segregation

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.**

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 IF IN LEASE
- Can be >50% of income

Types of Oil/Gas Leases

- Oil and Gas Lease: Per acre annual rent paid until royalty received – State of MI lease has
- Oil and Gas Lease (Paid up)
  - No annual per acre fee; included in bonus
- Oil and Gas Lease (No Surface Use)
  - Also called Non Development Lease
  - No surface disturbance or structures
  - No pipelines w/o owner permission

The “Standard” Lease Allows the Following Unless Mineral Owner Negotiates

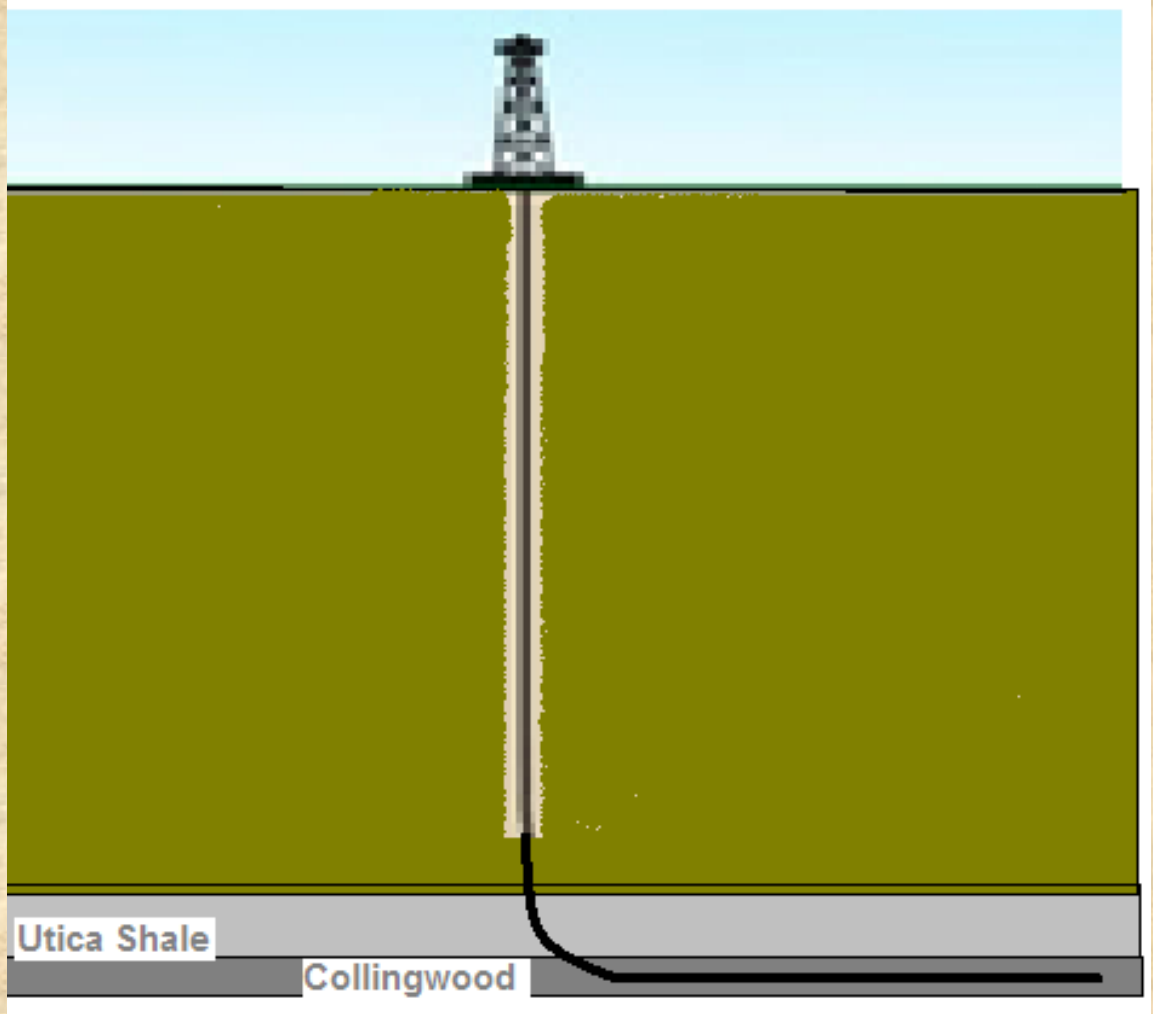
- Lease in effect “until production permanently ceases”; Alternative: “as long as producing in “paying quantities”


TEREX

Magnitude of The Royalty
Ideal Situation Using Gross Income

- Situation: 40 acres, one oil well @25 barrels/day for 200 days @ $90/barrel
- 25 x 200 x $90 = $450,000/ year
- 1/8 royalty = $56,250/yr = $1,406/acre/yr
- 1/6 royalty = $75,150/yr = $1,878/acre/yr
- 3/16 royalty = $84,375/yr = $2,109/acre/yr
- .20 royalty = $90,000/yr = $2,250/acre/yr

Horizontal Well



Can I be Forced to Lease? No

- If cannot negotiate acceptable lease Compulsory (statutory) Pooling an option
- Deals with one well not all your land
- It is not a lease - an order from Supervisor of Wells
- No lease bonus
- Royalty begins with oil and gas sales
- Mineral owner receives 1/8 cost free royalty
- Non development- no trespass

Compulsory (Statutory)Pooling Continued

- Treated as working interest owner (investor)
- 7/8 to company pays your share to drill, equip and complete well plus penalty
- After well paid for you receive 1/8 plus your owned share of well
- Does not “ruin it for your neighbor”
- Threat of compulsory pooling not a reason to sign a lease you do not like

WHAT A LANDOWNER NEEDS TO KNOW ABOUT MINERAL RIGHTS SALES

Definition of Mineral Property

- Mineral property is real property – can be severed from surface
- “Mineral” no universal definition
- Generally includes: Fossil fuels – oil, natural gas, and coal; Metals and metal-bearing ores such as gold, copper, and iron; Non-metallic minerals and mineable rock products such as limestone, gypsum, building stones and salt; May also include sand and gravel, peat, marl, etc.
- Can also include potassium, gases such as helium "mineral" can vary from state to state and even change over time

Characteristics of Mineral Sale

- Sale is generally forever
- Know what "Partnering Together" means in the sales contract
- Example: Sell 50 % **undivided interest** for $150/acre grants buyer 50% of future mineral income to 100% of property
- Can sell all, a portion, or divided interest
  - Example 50% interest of the **hydrocarbons**
  - Done by mineral deed

Characteristics of Mineral Sale Continued

- If no royalties, difficult to establish value
  - What are non-producing minerals worth?
  - Consult oil and gas appraiser

Characteristics of Mineral Sale Continued

- Seller loses control and leverage with eventual mineral developer
- New mineral owner no incentive to protect surface
- Get references on potential buyer
- Understand sales contract! Need qualified legal advice

MSUE Landowner Resources on the website:

- http://msue.anr.msu.edu/program/info/oil_and_gas
- Landowner Info For Oil and Gas Leasing (Curtis Talley)
- Video: “Understanding and Negotiating the Oil and Gas Lease”
- State of Michigan Oil and Gas Lease
- Oil and Gas Expert Resources for Private Landowners (attorney list)
- Right of Way (ROW) info for Landowners

Resources Cont.

- Fact Sheet: Compulsory Pooling and the Landowner that has not Leased
- Lease addendum on website
- Oil and Gas Newsletter contact talleycu@anr.msu.edu
- http://news.msue.msu.edu MSU Extension news articles
- News article series: Survey of Oil & Gas Attorneys
- Your county MSU extension office

Thank You

QUESTIONS?