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## Mineral Law 101:

### What to Do When Aunt Pauline Discovers She has Mineral Rights in North Dakota

Frank Erisman  
Schwabe, Williamson & Wyatt  
May 15, 2013

Bend, OR | Eugene, OR | Portland, OR | Salem, OR | Seattle, WA | Vancouver, WA | Washington D.C.

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## I. The Problem

What do you do when you discover mineral interests contained in a bequest or trust?

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## II. Kinds of Mineral Interests

- Fee Interest (see Exhibit A)
- Mineral Interest – The U.S.
- Leasehold Interest
- Surface Interest
- Royalty Interests
- Wheelage Royalty
- Overriding Royalty

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**Exhibit A - Aunt Pauline's Dilemma**

640 total acres  
Pauline: 80 acres of minerals

Swedish Berry Road

- Aunt Pauline – 40 acres of mineral rights
- ▨ Aunt Pauline – 40 acres of fee interest
- Bakken shale
- North Dakota state land
- ⊕ Proposed Well

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## II. Kinds of Mineral Interests (cont.)

- Non-participating royalty
- Term royalty (limited in time)
- Perpetual royalty (indefinite in time)
- Elements of Royalty Interest
- Production Payment
- Net Profits Interest
- Carried Working Interest

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## II. Kinds of Mineral Interests (cont.)

- Working Interest
- Division Order
- Net Revenue Interest ("NRI")
- Operator
- Pool
- Pooling Clause
- Forced Pooling or Compulsory Pooling

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## II. Kinds of Mineral Interests (cont.)

- Unitization
- Spacing
- Frack
- Horizontal Drilling
- Net Smelter Returns

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## III. Rights Affecting Mineral Interests

- Dormant Mineral Acts
  - See exhibit B

## IV. Value

- Appraisers
- Consultants

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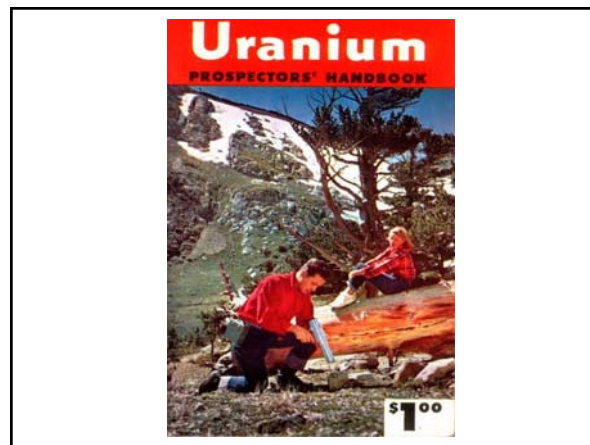
## V. Liabilities

- See exhibit C

## VI. Selling a Mineral Property

## VII. Right of Reentry for Condition Broken

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## **NORTHWEST PLANNED GIVING ROUNDTABLE**

**May 17, 2013, Membership Meeting  
Portland MAC Club**

### **MINERAL ADMINISTRATION – DUE DILIGENCE IN ACCEPTING AND ADMINSTRATING MINERAL INTERESTS**

**FRANK ERISMAN**

**SCHWABE, WILLIAMSON & WYATT**

I. **The Problem:** What do you do when you discover minerals interests contained in a bequest or trust assets?

- A. What is a mineral interest?
- B. Does it have any value?
- C. Are there potential liabilities? Should it be taken?
- D. Can it be sold?
- E. What this talk is not: specific analysis of specific laws. Louisiana is always different.

II. **Kinds of Mineral Interests:**

- A. Fee Interest
  - 1. Generally, ownership of both surface and mineral rights in fee simple absolute
  - 2. Oil and gas industry -the entire bundle of real estate rights on real property
  - 3. See Exhibit A – Aunt Pauline’s Dilemma
- B. Mineral Interest – The U.S.
  - 1. In the U.S. owner of real property can transfer rights in whole or in part
  - 2. Generally includes the right to use the surface

3. Elements of mineral interest ownership:
  - a. Right to profits and the obligation for costs,
  - b. Right to lease or sell the mineral interest,
  - c. Right to benefits under a mineral lease.

C. Leasehold Interest

1. The right to the mineral interest granted by a mineral lease
2. Often referred to as the working interest or the operating interest
3. Unleased mineral interest owner or fee owner also has right to operate rights after it has been severed from the fee estate

D. Surface Interest

1. What remains in the bundle of property rights after the mineral interest has been severed from the fee estate
2. All the rights not included in the mineral interest
3. Times are changing
  - a. Dominant vs. subservient estate
  - b. Oregon land use laws.
  - c. Public's perception
4. Often includes rights to uses not often considered part of the surface
  - a. Geothermal rights
    - (i) ORS § 522.035 states "ownership right to geothermal resources shall be in the owner of the surface property underlain by the geothermal resources unless such rights have been otherwise reserved or conveyed.
    - (ii) Court interpretations of Federal Stock Raising Homestead Act hold surface owner owns geothermal resources but government owns sand and gravel.
  - b. Wind rights
  - c. Water rights
  - d. Rights to store natural gas or oil in substrata
5. Typically subject to an implied easement for the mineral owner to use so much of the surface as is necessary to explore for and develop mineral estate

6. Little understood by surface owners and politicians
- E. Royalty Interests
1. Normally considered a share of production or value of proceeds of production, free of costs of production
  2. Usually expressed as fractions; 1/8th, 3/16th, etc.
  3. With aggregates usually set amount per ton - \$1.00/ton; 25¢/ton.
- F. Wheelage royalty - Payment to allow transport of mineral across or under land.
- G. Overriding Royalty
1. Generally carved out of lease
  2. That is, paid by the lessee to either a prior leasehold owner, a lease broker, a lawyer or geologist. Typical way to pay for exploration.
- H. Non-participating royalty
- I. Term royalty (limited in time)
- J. Perpetual royalty (indefinite in time)
- K. Elements of Royalty Interest
1. No right of surface use, ie., a passive interest
  2. Not profit sharing or cost bearing
  3. No right to grant lease
  4. Does not share in lease benefits, this is bonus, surface rent, etc.
  5. Be alert to “net profits royalty common in mining industry”
- L. Production Payment
1. Share of production or value of proceeds free of costs of production that terminates when an agreed sum has been reached
  2. Historically used in lieu of a mortgage as a financing tool
  3. Common in mining industry as a means for a transfer or to cover costs from buyer
- M. Net Profits Interest
1. Differs from a royalty - Typically only paid out of profits, if at all; think Hollywood
  2. Very common mining interest

N. Carried Working Interest

1. Generally paid in relation for work related to the prospect
2. This interest is paid, or carried, for the drilling and or completion costs as specified in the contract between the parties, by another working interest owner, typically until casing point is reached, or through the tanks, meaning through completion of the well, as agreed upon contractually.

O. Working Interest

1. A percentage of ownership in an oil and gas lease granting its owner the right to explore, drill and produce oil and gas from a tract of property.
2. Owners are obligated to pay a corresponding percentage of the cost of leasing, drilling, producing and operating a well or unit. After royalties are paid, the working interest also entitles its owner to share in production revenues with other working interest owners, based on the percentage of working interest owned

P. Division Order

1. An agreement between the operator and net revenue interest (NRI) owner in which the parties specify the fractional type of interest attributed to the NRI owner by the operator after an examination of title.
2. Purchaser of production requires execution before payment.

Q. Net Revenue Interest ("NRI")

1. An interest usually expressed as a decimal in a revenue stream, net of all of the interests burdening that stream of revenue.
2. Where a lessor executes a lease with a one-eighth royalty, the lessor's net revenue interest is 0.125 and the lessee's is 0.875.
3. If there is a five percent overriding royalty interest then the net revenue interests are: lessor – 0.125; lessee - 0.825; and overriding royalty owner - 0.050

R. Operator – the person or entity designated by the owners to operate a well or mine.

S. Pool

1. To combine two or more tracts of land into one unit for drilling purposes
2. May be voluntary, or through compulsion pursuant to state law
3. Can be used to extend lease
4. See Exhibit A – Aunt Pauline's Dilemma

T. Pooling Clause

1. A lease clause authorizing a lessee to pool or join the particular leased premises with other leases for the purpose of aggregating a tract sufficient for a well permit under applicable state spacing regulations.
2. May also permit the lease to unitized the leased premises with other parcels.

U. Forced Pooling or Compulsory Pooling

1. The bringing together, as required by law or a valid regulation or order, of separately owned interests sufficient for the granting of a well permit under applicable spacing rules.
2. Nearly all producing states allow for compulsory pooling
3. Purpose is to avoid waste and ensure production of the resource without drilling of unnecessary wells

V. Unitization

1. Often confused with pooling or used in place of pooling.
2. However, this is a different concept that denominates the joint operation of all or some portion of a producing reservoirs distinguished from pooling, which relates to describe the bringing together of small tracts sufficient to obtain a well permit under applicable spacing laws.

W. Spacing

1. The area allocated to a well under a well spacing order. Production from a well on a spacing unit is considered as occurring from all tracts within the spacing unit for purposes of the rights of mineral owners.
2. Bakken spacing is 640 or 1280 acres

X. Frack

1. A method used to increase the deliverability of a production well by pouring “a liquid of other substance into a well under pressure to crack (fracture) and prop open the hydrocarbon bearing formation.”
2. Also can be done with explosives.

- Y. Horizontal Drilling - Technique whereby the well is initially drilled vertically and then turned a drilled horizontally at an angle to the vertical of anywhere from 79 degrees to 104 degrees; High angle directional drilling
- Z. New Smelter Returns – the gross revenue (total revenue minus production costs) that the owner of a property received from the sale of a mine’s metal products; usually after transportation and refining costs but all definitions are different.

### III. **Rights Affecting Mineral Interests:**

#### A. Dormant Mineral Acts

1. Applied to state statutes designed to extinguish severed mineral interests or perpetual royalty interests
2. Are effective where there has been no exploration, development, operations or act of recording
3. Texaco v. Short, 454 U.S. 516 (1982) U.S. Supreme Court upheld constitutionality of an Indiana statute
4. Prior to Short, several state supreme courts had thrown out their dormant mineral acts
5. Oregon’s act can be found at ORS 517.180 – See Exhibit B.
6. Generally positive action must be taken by the surface owner

### IV. **Value.**

#### A. Appraisers.

1. American Institute of Minerals Appraisers (AIMA).
2. Heavy on coal and hard minerals.
3. Found at: mineralappraisers.org

#### B. Consultants

1. Gustavson Associates – covers hard minerals, coal, oil and gas: gustavson.com
2. Gary Hutchinson – 303-279-4113
3. University professors – mineral economics professors

### V. **Liabilities**

#### A. Similar to any other real property interest but more so

1. Numerous superfund sites were former mines
2. Water quality issues are always possible

3. Abandoned shafts
4. Aquifer contamination

B. Exhibit C – Statement of Guidelines; the Colorado School of Mines example.

**VI. Selling a Mineral Property.**

- A. The knock on the door; sit and wait approach
- B. Aggressive
  1. The Oil Gas Asset Clearinghouse
  2. [www.ogclearinghouse.com](http://www.ogclearinghouse.com)
  3. Online auctions, actual auctions, negotiated sales.

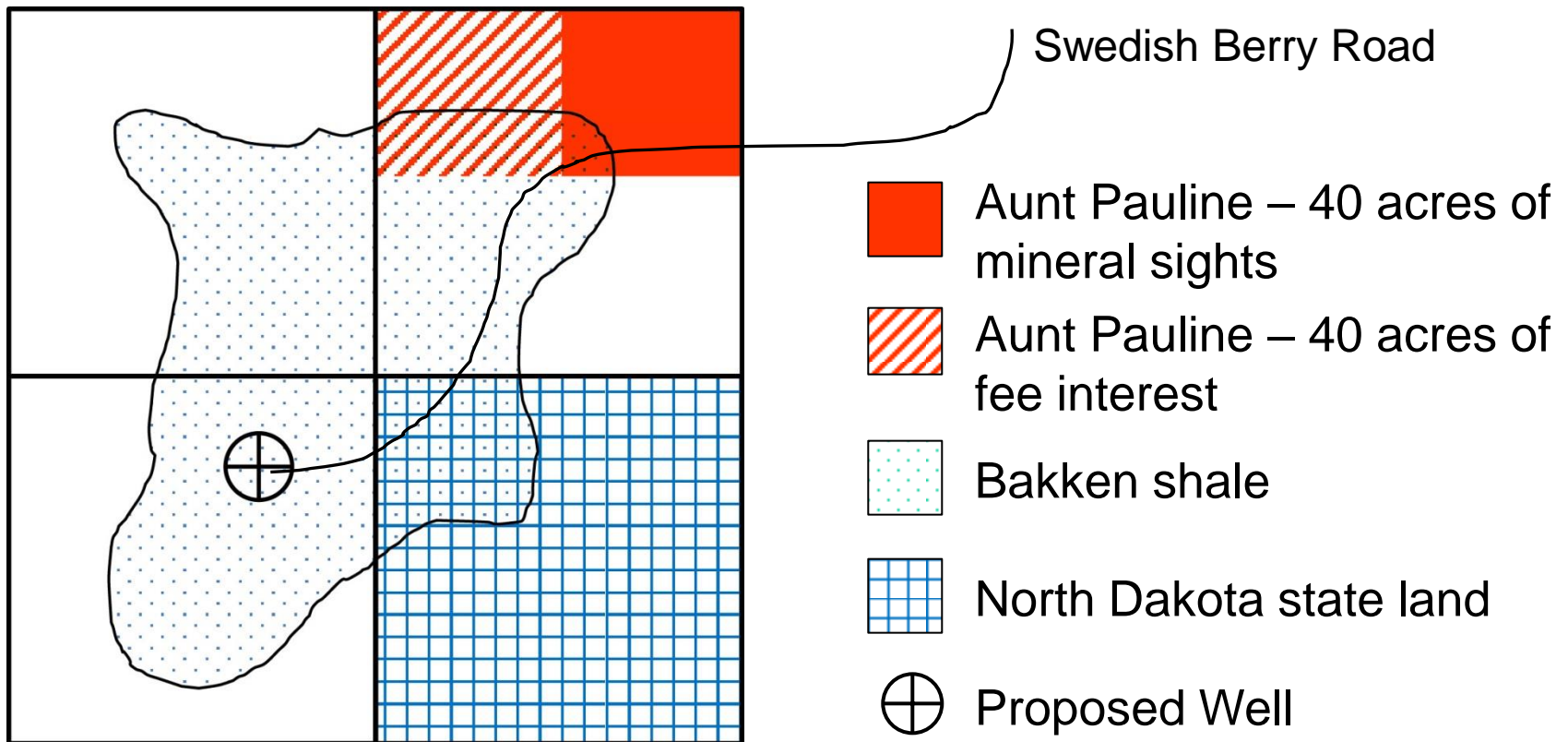
**VII. Right of Reentry for Condition Broken**

- A. *Jelen and Son, Inc. v. Kaiser Steel Corporation, et al.*, 807 P.2d 1241 (Co.Ct.App) (1991)
- B. Based on 1977 general warranty and quitclaim deeds that required reversion of property to original owner if advanced minimum royalty payments were not paid over a 15-year period.
- C. Court upheld reversion.

# Exhibit A - Aunt Pauline's Dilemma

640 total acres

Pauline: 80 acres of minerals



Section 517.180 Procedure for extinguishing dormant mineral interest

(1) An owner of land in which another person holds a mineral interest, may extinguish the holder's interest by publishing notice and submitting an affidavit of publication for recording as described in subsections (4) to (9) of this section, unless:

(a) Within the last 30 years, the holder of the mineral interest has submitted a statement of claim for recording in the manner set out in subsection (3) of this section; or

(b) The holder of the mineral interest acquired the mineral interest within the previous 30 years.

(2) For the purposes of this section:

(a) "Mineral interest" includes any interest that is created by an instrument transferring, either by grant, assignment, reservation or otherwise, an interest of any kind in coal, oil, gas or other minerals and geothermal resources, except an interest vested in the United States, the State of Oregon or a political subdivision of the State of Oregon. A mineral interest does not include an interest in sand or gravel.

(b) "Owner of land" includes a vested fee simple owner or a contract purchaser.

(3) The statement of claim referred to in subsection (1) of this section shall be submitted for recording in the office of the clerk of the county in which the land affected by the mineral interest is located and shall contain:

(a) The name and address of the holder of the mineral interest as that name is shown in the instrument that created the original mineral interest; and

(b) The name and address of the current holder of the mineral interest.

(4) To extinguish the mineral interest held by another person, and acquire ownership of that interest, the owner of the land shall publish notice of the lapse of the mineral interest at least once each week for three consecutive weeks in a newspaper of general circulation in the county in which the lands affected by the mineral interest are located. If the address of the mineral interest holder is known or can be determined by due diligence, the notice shall also be mailed by the owner of the land to the holder of the mineral interest before the first publication.

(5) The notice required in subsection (4) of this section shall include:

(a) The name of the holder of the mineral interest, as shown of record;

(b) A reference to the instrument creating the original mineral interest, including where it is recorded;

(c) A description of the lands affected by the mineral interest;

(d) The name and address of the person giving the notice;

(e) The date of first publication of the notice; and

(f) A statement that the holder of the mineral interest must submit a statement of claim to the county clerk within 60 days after the date of the last publication or the mineral interest of the holder may be extinguished.

(6) A copy of the notice and an affidavit of publication of the notice, as described in subsection (7) of this section, shall be submitted to the county clerk within 15 days after the date of the last publication of the notice in the office of the clerk of the county where the lands affected by the mineral interest are located.

(7) The affidavit of publication shall contain either:

(a) A statement that a copy of the notice was mailed to the holder of the mineral interest and the address to which it was mailed; or

(b) If no copy of the notice was mailed, a detailed description, including dates, of the efforts made to determine with due diligence the address of the holder of the mineral interest.

(8) If the owner of the land affected by the mineral interest gives notice as required in subsection (4) of this section and submits a copy of the notice and the affidavit of publication for recording as required by subsection (6) of this section, the mineral interest of the holder shall be extinguished and become the property of the owner of the lands, unless the holder of the mineral interest submits a statement of claim to the county clerk within 60 days after the date of the last publication of the notice.

(9) Upon receipt, the clerk of the county shall record a statement of claim or a notice and affidavit of publication of notice in the Mineral and Mining Record. When possible, the clerk shall also indicate by marginal notation on the instrument creating the original mineral interest the recording of the statement of claim or notice and affidavit of publication of notice. The clerk of the county shall record a statement of claim by cross-referencing in the Mineral and Mining Record the name of the current holder of the mineral interest and the name of the original holder of the mineral interest as set out in the statement of claim.

(10) The provisions of this section may not be waived at any time. [1983 c.421 §2; 1997 c.819 §10; 1999 c.654 §31]

ASSESSMENT WORK

## **EXHIBIT C**

### **EXAMPLE OF REAL PROPERTY MANAGEMENT COMPANY**

**FRANK ERISMAN  
MAY 17, 2013 TALK**

#### **XYZ PROPERTY MANAGEMENT CORP.**

#### **STATEMENT OF GUIDELINES**

\_\_\_\_\_, 2013

The purpose of XYZ Property Management Corp. (the “Corporation”) is to solicit and accept gifts, grants, bequests and devises of real and personal properties acceptable to the Corporation, to hold, manage, maintain, develop and improve such properties, with the ultimate purpose that such properties shall be sold, leased, exchanged or otherwise disposed of, as the Corporation shall deem appropriate, all for the potential benefit of the Foundation [the benefiting nonprofit], Incorporated.

#### **A. Accepting Properties**

Criteria. Acceptance of any property should be subject to economic, environmental, social and political risk evaluation. Evaluations should be made in sufficient detail so as to economically, scientifically, and legally predict that the Corporation shall be reasonably assured of generating an increase in net assets of the Corporation as a result of accepting each property or groups of properties. The Corporation shall be risk adverse in its decisions to accept a property. Acceptance should be denied for a property determined to have a high potential of risk to present or future assets of the Corporation or its long term ability to generate revenue.

To meet its goal, the Corporation, for each property it believes to be acceptable, will consider:

- (1) Evaluating the property to determine its fair market value to the Corporation;
- (2) Conducting a preliminary screening of the property including appropriate inquiries of previous owners, lessees, and Federal and State agencies to identify potential liabilities. A further investigation of liabilities may be determined to be necessary depending on the potential for risk of the property under consideration; and
- (3) Evaluating a property under investigation by an environmental authority or subject to an authorized state or federal clean-up more critically.

Properties considered favorable to the Corporation should, but may not necessarily, fall within one of the following categories:

- Properties capable of being transferred to a third party without the Corporation taking title to the property;
- Properties capable of being sold or otherwise divested of in a timely manner;

- Properties having adequate revenue potential and capable of generating an increase in net assets for the longer term with minimum risk may be retained by the Corporation or a title-holding subsidiary; or
- Properties having some other value to the Corporation.

Site Visit and Analysis. Prior to accepting receipt of any real property interest by the Corporation, the Board or Board designee may inspect the real property. The University Advancement gift planning committee will review all required documentation. They will analyze the following, among other things:

- (a) Market conditions for resale or the ultimate disposability of the property;
- (b) The condition of any improvements located on the property;
- (c) Current and potential zoning, land use, and concurrency issues;
- (d) Any costs associated with holding the property for resale; and
- (e) Other considerations specific to the acquisition of the property.

Business Strategy. Prior to acceptance of a property, the Board shall determine a plan of acquisition, management, income projection and disposition. The developed strategy shall be adhered to until the general strategy for each accepted property is amended by the Board.

Mortgaged Property. The Corporation rarely accepts mortgaged property and never accepts mortgaged property into a charitable remainder unitrust. Real property may be acquired subject to a mortgage, if the mortgage is current and assumable and only following Board of Director's approval. Prior to acceptance:

- (a) A clearly established method for the payment of the debt must be determined;
- (b) An MAI/SRA appraisal will be required; and
- (c) The loan-to-value ratio must not be more than 50 percent.

Indemnity. Indemnity provisions should be included in all documents transferring title to the Corporation, if and when practical for the anticipated transaction.

Experts. The Corporation may make use of experts in its evaluation of value and risk. Expert reports may include professional opinions of officers and directors of the Corporation. Technical experts may be made available by the [benefitting non-profit], as well as, individuals and organizations involved in making the appropriate evaluations for the general public, industry or government.

Environmental Evaluation. Many of the properties offered to the Corporation may be of or related to the mineral extractive industries because of the educational support of those industries by the [benefitting non-profit]. The Corporation shall evaluate the acceptance of properties in regard to current environmental laws and their affect on the property and its owner(s).

The Corporation should objectively evaluate the environmental risks in comparison to the revenue generating potential of a property.

No interest in real property, whether outright, in trust, by bequest, as a secured interest, or otherwise, will be accepted by or on behalf of the Corporation without first complying with the following procedures:

An environmental review as described below shall be performed on every potential real property asset prior to acceptance by the Corporation. The environmental review will be performed by the person or firm selected by the Board of Directors (approved consultant). Each environmental review will be reviewed and approved by the Board of Directors.

#### Residential, Rural or Agricultural

For real property located in a developed residential community, a rural area, or an agricultural area, an approved consultant will perform an Environmental Risk Assessment.

#### Industrial

For real property located in a developed area where manufacturing of any class of industrial activity may have taken place, an approved consultant will perform a Phase I audit.

#### High Risk Operation

For real property with present or past high-risk operations, an approved consultant will perform a Phase I audit.

If the environmental review indicates areas of significant concern, an additional investigation, including a Phase I, Phase II, or Phase III audit, as recommended, will be performed by an approved consultant prior to acceptance of the real property. If the above procedures disclose risk of liability, the real property will only be accepted with the approval of the Executive committee or the Board of Directors. All contracts for environmental audits will be prepared and reviewed by the Foundation legal counsel.

The donor must pay for any assessments and audits.

Time Share Units. Time-share units will not be accepted.

#### Other Evaluations:

For the evaluation of most real properties, the following subjects should be considered prior to acceptance: zoning, liens, encumbrances, taxes, general liability, safety considerations, title, history of use and other special aspects of a particular property.

### **B. Managing Retained Properties**

The Corporation shall manage each property in reasonable accordance with the business strategy determined during its acquisition.

The Corporation will pursue a prudent and reasonable course of risk management through the use of available resources. The Corporation seeks to comply with federal, state, and local requirements pertaining to environmental protection, occupational health and safety, public safety and building, fire and sanitation codes.

When there is an objective possibility that the Corporation may become the operator of a property, reasonable efforts shall be made to establish an appropriate environmental policy for operations by the Corporation prior to accepting and retaining a property. The policy for operations shall include, but not limited to, considerations for discovery of regulated materials, identification and handling of regulated and hazardous materials, if any, minimization of waste generation, and acceptance of waste or regulated materials.

For the acceptance of existing leases and for the generation of new leases, reasonable environmental policy requirements, assurances, and indemnities should be obtained from lessees of retained properties, with rights of periodic review and revision as appropriate to each lease document and transaction to the extent possible and reasonable.

### **C. Divesting of Assets**

It is not the intent of the Corporation to accumulate liquid assets. Liquid assets of the Corporation shall be transferred periodically to the Foundation in amounts deemed reasonable and appropriate by the Board.

## DEAR NEW YORKER:

In the first decade of the 21st Century, gas exploration has evolved from a predominately regional operation into a large-scale business, attracting national and global companies. As a result, production of natural gas has significantly increased.

This evolution is a direct result of higher natural gas prices coupled with improvements in both gas exploration and extraction technologies.

These advancements have furthered the exploration and extraction of natural gas from two formations that had been previously difficult to tap - the Trenton-Black River and Marcellus Shale.

If done properly, and with proper environmental safeguards, the increased production of natural gas can be a benefit to the landowners, economy, and all New Yorkers. It has already generated significant revenue for energy companies, and some landowners. The companies and the government must be vigilant to protect our environment throughout the process.

In addition to raising environmental concerns, some landowners have complained to my office about abusive, misleading, and/or fraudulent tactics used by certain exploration and development companies, or their agents, in an effort to obtain a lease. If you believe that you have been defrauded by an unscrupulous landman or gas exploration company, or if you have environmental concerns, please contact my office at 1-800-771-7755.

I want to share with you some general information in the event you or someone you know is approached and asked to sign a lease. I hope you find the information contained in this pamphlet useful.

Sincerely,



Andrew M. Cuomo  
Attorney General



## HOW TO ENTER INTO AN OIL AND GAS LEASE

Most landowners who have entered into an oil and gas lease have been approached by a person directly or indirectly representing a gas operator.

This person is commonly referred to as a landman. The landman's main purpose is to secure leases on as large an area as possible.

Landmen may approach landowners at their homes or businesses, or may contact landowners preliminarily by telephone before meeting with them in person.

## WHAT IS AN OIL AND GAS LEASE?

In very general terms and in the context of mineral rights and exploration, a lease is a written instrument where the landowner (the "lessor") grants to a business (the "lessee") the right to extract oil and natural gas from beneath a landowner's property.

Like many other types of leases, the rights and obligations of the lessor and the lessee are detailed in the lease and, in most cases, landowners will be bound for the duration of the lease to those terms and conditions.

In addition, the lessee will record either the lease or a memorandum of lease at the local county clerk's office.

Thereafter, if you want to sell your property, the buyer will have to accept that lease along with it. In other words, the rights and obligations set forth in the lease are connected to your land.

For this reason, and because of the complexity of oil and gas leases, the Attorney General strongly recommends that before signing a lease you contact an attorney to secure professional, personalized advice in this important transaction.

## LANDOWNER'S TIPS

If you are thinking about signing an oil and gas lease, consider the following:

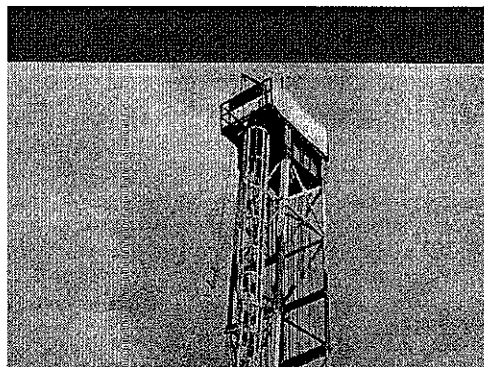
1. **CONSULT AN ATTORNEY**  
before you sign a lease, and review each term and condition of the lease with your attorney.
2. **ASK ALL NECESSARY QUESTIONS**  
to ensure that you understand all terms and conditions on the lease.
3. **OBTAIN IN WRITING**  
all promises and conditions, and make sure those written promises are part of the lease.
4. **NEGOTIATE**  
as you may get better terms than those initially offered to you.
5. **SEARCH FOR**  
and negotiate with more than one gas operator.
6. **THERE IS STRENGTH IN NUMBERS**  
so consider negotiating your lease together with a group of neighbors or interested parties.
7. **OBTAIN COPIES**  
of the lease you sign and a copy of the lease signed by both you and the gas operator to make sure that the lease reflects the agreement reached with the landman.
8. **THE RIGHT TO CANCEL**  
is yours for 3 business days after signing the lease, but to cancel, you must comply strictly with all requirements (consult your attorney).

The New York State  
Office of the Attorney General  
1-800-771-7755  
www.oag.state.ny.us

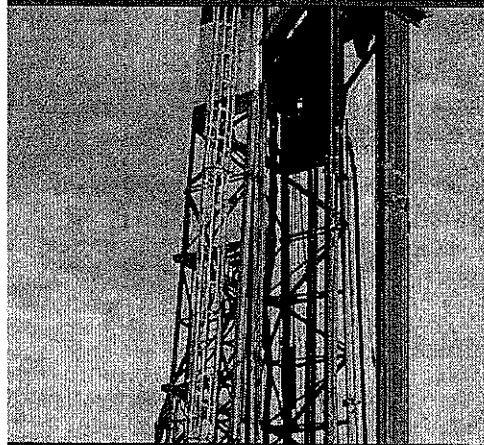
August 2008



Printed on recycled paper.




## OIL & GAS LEASES: LANDOWNERS' RIGHTS



NEW YORK STATE  
OFFICE OF THE ATTORNEY GENERAL

**ANDREW M. CUOMO**  
ATTORNEY GENERAL



## FOUR KEY TERMS IN OIL AND GAS LEASES

### THE LEASING CLAUSE

This clause describes in general terms what rights the lessor is granting the lessee, such as "the right to access and extract oil, gas and their constituents" and "all exclusive rights needed to explore, develop, produce, measure and market production." This includes the right to conduct exploratory tests, drill wells, and use or install roads on a landowner's property.

### THE LEASING TERM CLAUSE

The leasing term usually consists of a primary term and a secondary term. Generally, the primary term is explicitly stated as a number of years. The secondary term, however, can extend the duration of the lease indefinitely into the future if gas production is ongoing or if one or more specific events occur, like continued rental payments.

### THE BONUS PAYMENT CLAUSE

The bonus payment is the amount of money landowners receive as consideration for signing the lease. It may be a fixed amount or it may be a dollar-per-acre amount.

### THE ROYALTY PAYMENT CLAUSE

A royalty is the landowners share of the proceeds from the sale of oil, gas, and other constituents. This clause will determine what percentage a landowner will receive and what deductions, if any, will be made from the sale price before the landowner receives his or her royalties.

## PROBLEMS WITH LANDMEN

### MISLEADING OR MISUNDERSTOOD STATEMENTS

#### TOP 5

**1. "Your property will [or won't] be in the unit."**

Neither the landman nor the gas operator can guarantee that any property will be part of a spacing unit because the New York State Department of Environmental Conservation (NYSDEC) makes this determination.

A landman could let you know whether an operator has proposed a spacing unit containing or excluding a specific property, but any statement purporting to guarantee the inclusion of a property in a spacing unit is misleading.

**2. "This is the standard lease, and it's not negotiable"**

There is no such thing as a standard lease in the oil and gas leasing business. All leases and all terms in the lease - except for those terms required by law - are negotiable.

**3. "All your neighbors have signed, and you're the sole person holding everything up"**

It is highly unlikely that you are holding up the transaction. While it might not be misleading to state that all the neighbors have signed (if, indeed, they have signed leases), it is rarely the case that a landowner's reluctance to sign a lease alone is holding everything up.

The NYSDEC requires gas operators to control a minimum of 60% of the property with the proposed spacing unit and 100% of the property through which the well would be drilled. If the size of one property within the proposed unit is such that the gas operator cannot reach that minimum percentage without that property, or cannot drill the well-bore without traversing through that property, then the statement would be accurate.

**4. "Don't you want to receive \$X every month"**

The amount of money a landowner receives in royalties is a function of several different factors that change from one day to the next. Therefore, no landman can give you a reasonable estimate of how much money you will receive in royalties. A landman, however, may use examples to show you how your royalties will be calculated.

**5. "If you don't sign, we'll take the gas from your property without paying you"**

The law in the State of New York does not allow this to happen. If a landowner is located within a unit, she will share in the royalties generated within that unit in the proportion allocated to her property.

### PRESSURE TACTICS

Remember, it is your property, and you have the right to decide who can come on it, or contact you.

#### FEELING UNDER PRESSURE? CONSIDER THE FOLLOWING:

1. Obtain the full name, address, and telephone number of both the landman and the business they represent.
2. Direct the landman to leave the property and to not return or contact you again.
3. Write a letter to the landmen and the business they represent, restating the above request.
4. Consider contacting local law enforcement to determine if additional action is necessary.

### VERBAL PROMISES VS. WRITTEN DOCUMENTS

Verbal promises should be put in writing. It is essential that every single promise and agreement be in writing and included in the lease.

### FAILURE TO PROVIDE A COPY OF THE LEASE

Landowners should demand a copy of the lease within a reasonable time after they sign it. In addition, landowners should request the landman leave them a copy of the lease before it is signed by the gas operator.

## PROBLEMS WITH THE LEASE

As noted previously, the leasing clause grants the lessee many rights beyond the right to extract oil and gas. Before deciding whether to sign a lease, landowners should pause to consider what type of uses they want to allow on their properties. For example, while one landowner would not object to allowing gathering pipelines to be installed on his property, another may find such intrusion to be unacceptable.

### LEASE DURATION

Landowners should also be mindful of those conditions that will extend the duration of the lease beyond its primary term. Before signing a lease, the landowner should understand how the lease will operate, including whether it will trigger a secondary term, and, if so, when.

### ROYALTIES

Landowners should understand exactly what they are receiving in royalties. For instance, if the lease calls for an 18% royalty payment, know how will it be calculated and how to independently verify that you are receiving the correct amount of royalties.

### DISPUTES

Another issue that landowners must consider is how would a dispute between the lessor and the lessee be resolved. The so-called "standard leases" contain a provision requiring the use of arbitration, typically involving a panel of three arbitrators. The lessee and lessor each pay the fee for an arbitrator and they split the fee for the third arbitrator. This can result in a significant outlay of money just to have your grievance heard.