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This newsletter is intended for landowners and other members of the public with interest in the oil and gas industry. If you would like to be added to the e-mail list to receive this newsletter, please contact the editor. You can also contact your local county MSU Extension Office to obtain copies of the newsletter and other free oil and gas leasing information.

MSU Extension has a web page that contains information for mineral and landowners regarding oil and gas leasing and other related informational topics at

http://msue.anr.msu.edu/program/info/oil_and_gas

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NORTHERN MICHIGAN MINERAL OWNERS COALITION **CONTACT INFORMATION**

Curtis Talley Jr. Farm Management Educator Michigan State University

The September issue of this newsletter announced that a coalition of mineral rights owners have formed and adopted the name Northern Michigan Mineral Owners Coalition (NMMOC). That article incorrectly listed their contact information. The correct contact information is: Fred Miller at fwmiller46@charter.net or call him at 636-209-4404. In the three months since forming, NMMOC has added over 100 owner groups representing over 10,000 acres located in nine counties. At the current time, membership is open to any mineral owner with property located in the northern half of the Lower Peninsula.

Mineral Management Section of the Department of Natural Resources
Answers Questions Regarding State of Michigan Mineral Rights
Management

Curtis Talley Jr. Farm Management Educator Michigan State University

The Michigan Department of Oil, Gas and Minerals, a section of the Department of Environmental Quality is tasked with regulating the oil and gas industry in Michigan. They are not involved with managing and leasing state owned mineral rights. That task is handled by the Department of Natural Resources Lease Management Section.

The supervisor of the Lease Management Section, Julie Manson provided the author with answers to questions we frequently receive regarding State of Michigan minerals management. Below are a series of questions posed to Julie and her responses. CT is the author and JM is Julie Manson. Lessee refers to the oil and gas company and Lessor refers to the State of Michigan.

CT: What, if any rights does the surface owner have related to oil and gas production if the minerals are owned by the state? Does the State of Michigan oil and gas lease contain provisions that require the company to contact the surface owner to try and work out an agreement for the use of the surface? What happens if that agreement cannot be reached? How often is an agreement not reached?

JM: *The mineral estate is considered the “dominant estate”. What that basically means is that a surface owner must allow the mineral owner “reasonable use” of the surface in order to pursue development of those rights.*

Our current oil and gas lease contains the following language:

- 1. The Lessee shall pay or agree upon payment to the surface owner, or any person holding under the owner, for all damages or losses (including any loss of the use of all or part of the surface), caused directly or indirectly by operations hereunder, whether to growing crops or buildings, to any person or property, or to other operations.*
- 2. Before a drilling permit application is submitted to the Supervisor of Wells relating to land in which the State of Michigan owns mineral rights only, and as described in this Lease, proof shall be submitted to the Lessor, in writing, that notification to enter the land has been provided to the surface owner and that either voluntary agreement or stipulated settlement relative to surface use and damages has been reached between the Lessee, or the Lessee's authorized agent, and the surface owner or G(3) is invoked.*
- 3. When a mutually satisfactory agreement relative to surface use and damages cannot be reached, either party can inform the Lessor, in writing, that a dispute exists and the Lessor will grant a negotiation period of thirty (30) calendar days in which no drilling or development operations may be conducted by the Lessee. This time period is to allow for the resolution of the dispute.*

4. *If, at the end of this period, proof of the agreement is not submitted in writing to the Lessor, drilling and development operations will not be prohibited by the Lessor and resolution of the dispute rests solely with the Lessee and the surface owner independent of the Lessor. It is the sole responsibility of the Lessee to ensure that said thirty (30) day negotiation period is completed thirty (30) days prior to the expiration of the primary term or any extensions of this Lease.*

It is not common for us to receive a request for a “30-day cooling off” period from either the Lessee or the surface owner. Based on our records, we have received 5 such requests (all from the Lessee) in the last 5 years. The granting of the “30-day cooling off” period dictates that no drilling or development work can occur until after the time period has passed. This gives both the Lessee and the surface owner the incentive to get an agreement worked out. At the end of the 30 days, the surface owner cannot prevent the Lessee from pursuing development.

CT: Is there a law that dictates the mineral estate is dominant? If not, how did the mineral estate become dominant?

JM: *I am not an attorney, and cannot give legal advice. However, my understanding is that it is generally considered common law that the mineral estate is the dominant estate. Here are a couple of links to some very good information on the subject:*

<http://www.topplaw.com/pdf/SeveredMinerals.pdf>

<http://www.nedstratton.com/media/Surface%20Owner%20v%20Mineral%20Owner.pdf>

CT: Does a split estate surface owner (one owner of the surface and another owner of the minerals) have the potential to lease the state owned mineral rights under their property? If so, how does that person become qualified to bid at a DNR auction?

JM: *In order to bid at a State of Michigan oil and gas lease auction, the bidder must be on our authorized bidder list, or must provide a \$5,000 security deposit. Please see the details regarding registering to bid at:*

http://www.michigan.gov/documents/dnr/ProposedPubNotice_429506_7.pdf

If the bidder is successful, they must pay the full amount of the bonus bid the day of the auction, as well as at least the first year’s rental. In addition, the successful bidder must provide an oil and gas lease bond. The amount of the bond depends upon the total acreage under lease, but the minimum bond amount is \$10,000.

The primary term of the oil and gas lease is 5 years, and the auction leases contain two one-year extension options (Lessor’s option to extend upon request). At the end of five years the lease will expire if it is not included in a producing unit, or if an extension of the primary term has not been granted.

Once the lease expires, the oil and gas rights can be nominated for auction again. Unless the surface owner plans to pursue development of the oil and gas rights, it can be a rather costly endeavor.

Additionally, we do have a program in which the surface owner can pursue purchasing the severed mineral rights from the State of Michigan. However, the ability to sell those rights is impacted by the estimated value. Any nomination or leasing of the mineral rights will increase the estimated value of those rights.

CT: If the State of Michigan does not record their leases at a county recorder of deeds office, how can a person determine if the state owned minerals under their property are leased?

JM: *Our leasing information is available on-line at the following link:*

http://www.michigan.gov/dnr/1,1607,7-153-10371_14793-30992--,00.html

Our mapping software depicts ownership/leasing on a 40-acre or larger basis, so a property owner may wish to call our office to confirm the information displayed on the maps. The general number for our section is 517-373-7663 and any of our staff would be happy to answer questions. We ask that the caller have the legal description of their property (found on their tax bill or deed) available when they call.

CT: If the state owned minerals are leased, can the surface owner obtain and copy of the lease? If so, how do they do this?

Sure! Simply call our office at 517-373-7663 or e-mail me (mansonj@michigan.gov) and include their legal description (found on their tax bill or deed) and we would be happy to send or e-mail them a copy of the lease.

CT: How can a person determine if the state owns the minerals under their surface? Is there a map or registry available?

JM: *Our ownership information is available on-line at the following link:*

http://www.michigan.gov/dnr/1,1607,7-153-10371_14793-30698--,00.html

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Survey of Oil and Gas Attorneys Indicates Significant Positive Financial Results from Lease Bonus and Royalty Negotiations

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For the past three years, property owners in many areas of the state have been approached by oil and gas company land men with an offer to lease their oil and gas mineral rights. For many mineral owners, this may be their first exposure to an oil and gas lease contract. Landowners who have never dealt with leasing their mineral rights for oil and gas production, upon reading a lease, may have found that they had difficulty understanding the lease language.

In areas of potential mineral extraction activity, a group of Michigan State University Extension educators, led by Curtis Talley Jr., Michigan State University Extension farm business management educator initiated an educational program that provided public educational meetings, fact sheets, webinars, news articles and a quarterly landowner newsletter. A special web page http://msue.anr.msu.edu/program/info/oil_and_gas was created to display those resource materials. These resources provided information that would assist mineral owners in learning how the terms of the standard lease affect their businesses and their options in negotiating changes to the lease that put the agreement in line with their financial and environmental goals.

Because of the complexities of the oil and gas lease contract and its potential long-term life, MSU Extension recommended that a knowledgeable oil and gas attorney with experience working for private landowners be consulted to assist in negotiation of the oil and gas lease. “Oil and Gas Expert Resources for Private Landowners”, which included a list of oil and gas attorneys was available on the web page.

To begin the process of evaluating the financial impacts of this education, during the summer of 2013 a survey was mailed to oil and gas attorneys. The survey measured oil and gas lease terms “before negotiations” and “after negotiations” to determine what, if any financial or environmentally related lease terms were negotiated to benefit their clients.

Oil and Gas Lease Bonus Payment: The survey results indicated that each attorney represented an average of 8,018 acres of cropland each year. The first survey question dealt with the lease bonus. The bonus is a cash payment, usually in dollars per acre that is paid to the mineral owner after the lease is signed. The survey compared “the average initial bonus payment per acre offered” to the “bonus paid due to lease negotiations.” The average initial bonus offer was \$42 per acre. Lease negotiations increased the average bonus paid to \$124 per acre, an increase of \$82 per acre, or 195%. These nine attorneys, representing 8,018 acres each per year represented a total of 72,166 acres per year. At an increase of \$82/acre, they earned \$5,917,612 per year in additional gross income for their combined landowner clients. Determining fees charged to the

client were not within the scope of this study. Kevin McDugle indicates that the average lease should cost no more than \$1,000 in attorney fees.¹

Oil and gas lease royalty

Each oil and gas lease contains a royalty clause that allocates to the landowner a portion of the income produced as a result of the extraction of hydrocarbons. Economically, it is the most important term of the lease. Royalties can vary greatly from lease to lease, so it should receive close attention by landowners.

100% of the attorneys reported the initial royalty offer was 1/8 (.125). The survey found that in addition to the average bonus increase, as a result of negotiations, the average royalty increased to 1/6 (.167), an increase of 33.6%. All attorneys, except one, reported that on some leases, the royalty was increased to 3/16 (.188), an increase of 50% depending on the location of the land and the demand in the lease market for the mineral rights in that area.

To demonstrate the financial impact of the royalty, we can use an example oil well. For this example, we will assume the landowner is the sole owner of 40 acres and a successful well is drilled that produces 25 barrels/day. It operates for 200 days during the year and the oil sells for \$90/barrel. This well will produce \$450,000 in gross income (25 barrels/day x 200 days x \$90/barrel = \$450,000) in the first year.

Alt 1: .125 (1/8) royalty produces \$56,250 ($\$450,000 \times .125 = \$56,250$) for the landowner.

Alt 2: .167 (1/6) royalty produces \$75,150/yr. ($\$450,000 \times .167 = \$75,150$) for the landowner.

By negotiating a royalty increase to .167, in this example, the income is increased \$18,800 in the first year, or 33.4%. It is important to note that this increase lasts the entire term of the lease, so there is a compounding effect.

This article is one of a series to discuss the results of this survey.

Future articles will include:

1. Post Production Costs Negotiation Results
2. When Negotiations Were Not Successful, What did the Landowner do?
3. Environmental and Land Use Negotiation Results.

¹ Kevin McDugle, *How Much Will it cost to Hire an Attorney to Negotiate an Oil and Gas Lease?*

<http://www.youtube.com/watch?v=f0VISrrFkUI>

(March 2, 2012)

Landowner Informational Meetings

MSU Extension personnel, private attorneys specializing in assisting landowners with oil and gas leasing, personnel from the Department of Environmental Quality and representatives of the Michigan oil and gas industry offer public meetings to educate landowners about the oil and gas industry in Michigan, which includes understanding and negotiating oil and gas leases. If you would like a meeting in your area, please contact Curtis Talley.

Please Share Your Oil and Gas Experiences

The editor is very interested in hearing both your positive and negative experiences dealing with oil and gas leasing or production. All information is kept confidential and is combined with data from other landowners to analyze the effectiveness of the educational effort. Report your experiences to the editor by phone at 231-873-2129 or talleycu@anr.msu.edu e-mail.