



Issue Date: March, 2012

Editor: Curtis Talley Jr., MSU Extension Farm Management Educator, Hart, MI 231-873-2129;  
[talleycu@anr.msu.edu](mailto:talleycu@anr.msu.edu)

This newsletter is intended for landowners and other members of the public with interest in the oil and gas industry. Each newsletter is also posted on our website at [www.msue.msu.edu/oilandgas](http://www.msue.msu.edu/oilandgas). 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 MSU Extension Office to obtain copies of the newsletter and other free oil and gas leasing information.

### **Information in this Issue**

1. Upcoming landowner educational meetings
2. Farm Bureau an active partner in promoting oil and gas education
3. If I own 50% of the mineral rights and someone else owns the other 50% can I lease mine and the other party not lease theirs?
4. What's happening with Michigan oil and gas exploration?
5. Oil and gas leasing activity in Michigan
6. New oil and gas leasing webinar and DVD
7. Oil and gas leases; don't assume your title is "good"

### **Upcoming Landowner Educational Meetings:**

Washtenaw County Farm Bureau Oil and Gas Lease Educational Program

Monday, March 19, 2012

Lodi Township Hall, 3755 Pleasant Lake Road, Ann Arbor, MI

7:00 pm to 9:00 pm

Oil and Gas Leasing and Michigan Oil and Gas Industry Educational Meeting

Monday, March 26, 2012

Alpine Township Hall, 5255 Alpine Avenue Northwest, Comstock Park, MI

6:00 pm to 9:00 pm

\$10 suggested donation per household

Oil and Gas Leasing and the Michigan Oil and Gas Industry  
Thursday, March 29, 2012  
Ogemaw Heights High School, 960 South M-33, West Branch, MI  
6:00 pm to 9:00 pm  
\$5 suggested donation per person

If you would like an oil and gas, Michigan oil and gas industry educational meeting please contact your local Farm Bureau representative, extension educator, or the editor.

## **FARM BUREAU AN ACTIVE PARTNER IN PROMOTING OIL AND GAS EDUCATION**

Curtis Talley Jr. MSU Extension Farm Management Educator

Farm Bureau's Land Use and Elections Specialist Matt D. Kapp is very committed to providing landowners with educational materials to understand and negotiate changes to the lease. Farm Bureau has been the sole, or co-sponsor with MSU Extension of all the educational meetings we have held this winter. Farm Bureau regional representatives have been very active in securing meeting sites, organizing the sessions and promoting them. These meetings have been open to the public and have been well attended, with many standing room only.

## **IF I AM A MINERAL RIGHTS OWNER THAT OWNS 50% OF THE MINERAL RIGHTS AND SOMEONE ELSE OWNS THE OTHER 50%, CAN I LEASE MY 50% IF THE OTHER OWNER DOES NOT LEASE HIS?**

Corey J. Wiggins, attorney at law

Michigan provides that oil, gas and other mineral ownership/rights can be severed from the surface lands. As such, it is possible for a party to own the land and another party or parties to own the minerals under the same land. A severed mineral interest owner must meet certain statutory requirements (outside of the scope of this article) in order to retain their interest. If the requirements are not met, that person's mineral interest will revert to the surface owner. It is important to note that the State of Michigan and the federal government are not subject to these requirements, and, as such, government owned minerals will not revert to the surface owner.

Assuming that the leasing mineral owner holds the leasing privilege (executive right), a mineral owner has the right to enter into a lease under terms and conditions that can be negotiated with the lessee, i.e., the person to whom the lease is being granted. The law does not require the other owners of a mineral interest in the same property to enter into the same lease or any lease at all. However, it is possible, but highly unlikely, that the lessee will refuse to enter into a lease unless all of the interest owners enter into a lease. As hinted at above, it is possible that one party may have ownership of a royalty interest in a particular property and another party may hold an executive right to enter into a

lease for the same mineral interest. If another party holds an executive right, the mineral owner will be bound by the terms and conditions negotiated between the executive right holder and the lessee.

**In the event that the other mineral owner does not lease, how are the royalties distributed?**

In Michigan, the Supervisor of Wells is charged by the legislature with preventing waste in the production of oil and gas. To that end, the Supervisor establishes drilling units designed for the optimal production of oil and/or gas. A drilling unit is an area comprising land of a specific size and shape on which a single well to a specific formation can be drilled. Drilling units vary depending on the geographic location of the well and the formation that the well is anticipated to produce from. At times, a proposed drilling unit may include lands in which the minerals are not leased. In this case, a developer may request the Supervisor issue an order ordering the non-leased minerals be compulsory pooled into the drilling unit. However, before the Supervisor can issue his order, a public hearing must be held during which testimony and evidence will be taken to establish the need for the request. Furthermore, the non-leased owners have the right to participate in the hearing and will be given the option to participate in the cost of drilling the well or to accept a royalty interest and have their share of the cost of the well deducted from the proceeds of production over and above their royalty share. Once the cost of the well is recovered by the operator plus, generally, an additional sum to the operator in consideration of the operator taking the risk of a dry hole, the non-leased owner would receive 100% of the proceeds of production less its share of the ongoing cost of operation of the well. Operators will normally only take on the assumption of the cost associated with non-leased tracts or interests if it represents a relatively small portion of the proposed unit.

A “royalty” is the right to share in the production from an oil and/or gas well or the proceeds from the sale of the production produced from the lands subject to the lease or order, free of costs of drilling, equipping and operating the well, unless, in the case of a lease, the lease specifically provides for the deduction of post production costs. If a compulsory pooling order is entered by the Supervisor and a non-leased owner elects not to pay its share of the cost of a well out of pocket, the non-leased owner will receive a 1/8<sup>th</sup> royalty, cost free. The remaining 7/8ths will be deducted by the developer to cover the costs of drilling and production and paid pursuant to the terms of the Supervisor’s order and determined by the percentage of ownership in the minerals underlying the entire drilling unit. For example, if a drilling unit consists of 100 acres and a certain owner owns one-half of the minerals under a 20-acre parcel, that person’s royalty will be based on 1/10<sup>th</sup> of the production from the unit (20/100 x ½) times the royalty fraction.

**How are the royalties distributed if we each have separate leases with separate terms?**

The lessee is required to pay the royalty based on the terms contained in your lease, regardless of the terms negotiated with your co-owner. The amount of royalty paid will be based on the percentage of your ownership in the drilling unit times your royalty fraction. In the event revenue distribution is determined by the terms of oil and gas leases, the leases may provide for production units which exceed

the size of the Supervisor mandated drilling unit. In that event, the share of production proceeds will be determined by the size of the production unit.

*Corey J. Wiggins is a partner at the law firm of Zirnhelt, Bowron & Wiggins, P.L.C. located in Traverse City, Michigan. Corey's practice area focuses on oil and gas, real estate and municipal law throughout Michigan. Corey can be reached at (231) 946-8630 or [cwiggins@zbwlaw.com](mailto:cwiggins@zbwlaw.com).*

## **WHAT'S HAPPENING WITH MICHIGAN OIL AND GAS EXPLORATION?**

Dean Solomon Senior Extension Educator, Greening Michigan Institute [solomon@msu.edu](mailto:solomon@msu.edu)

Gas and oil production may be down in Michigan, but there are still opportunities for landowners to earn income from mineral leases.

There was much excitement during 2011 about new oil and natural gas exploration in the United States, and with it the prospect of lower long-term reliance on foreign sources. Pennsylvania, the center of dramatic natural gas drilling increases, saw a double-digit percentage rise.

Here in Michigan, 2011 was much more sedate. According to the Michigan Oil and Gas News, the state actually experienced a 16 percent decline in drilling activity compared to the previous year. Production, too, was down during the first half of the year (the most recent statistics available), with oil and natural gas declining five to six percent. There were bright spots in the state, especially in Jackson and Lenawee Counties due to new oil discoveries in those areas.

Also in 2011, seven wells were drilled into the Utica-Collingwood, the geologic formation that caused all the excitement (and concerns) during 2010. Those wells were or are planned to be developed using horizontal drilling and the controversial method of hydraulic fracturing (fracking). One well in Kalkaska County extended vertically approximately 8,500 feet and horizontally 8,200 feet. That horizontal leg was fracked in, reportedly, up to 30 stages. Initial test results are not public, but the Oil and Gas News reported that the Kalkaska County wells tested at "potentially commercial rates."

So what does this mean for Michigan landowners? On the one hand, drilling and production is down in Michigan. On the other, national momentum toward increased domestic oil and gas production is strong. There are still very active land men in the state purchasing oil and gas leases on private property and the potential exists for increasing drilling activity, even if not on the scale seen in Pennsylvania and other states. In many areas of the Lower Peninsula, landowners who own un-leased mineral rights could be approached by oil and gas company representatives.

It is still very important for landowners to learn as much as they can before entering into oil and gas lease negotiation and to seek professional advice from an oil and gas attorney before signing a lease. Additional oil and gas information is available at [www.msue.msu.edu/oilandgas](http://www.msue.msu.edu/oilandgas).

## **OIL AND GAS LEASING ACTIVITY IN MICHIGAN**

Curtis Talley Jr. Michigan State University Extension Educator

Despite the reduction in drilling in Michigan, as stated by Dean Solomon above, leasing of mineral rights has been surprisingly active. We are hearing of very numerous contacts to landowners by land men in Alpena, Alcona, Calhoun, Ogemaw, Arenac, Gladwin, Ionia, Kent, Barry, Oceana, Jackson, Hillsdale and Washtenaw counties.

**Landowners: I am very interested in learning about your oil and gas leasing experiences. All information I receive is kept confidential. I use this information to help other landowners by informing them of the changes that are being negotiated in leases, not the names of the people negotiating them. If you have positive or negative experiences dealing with oil and gas drilling, the payment of surface damages, post production cost deductions, working out access agreements and well site locations, please send them to the editor.**

## **NEW OIL AND GAS LEASING WEBINAR AND DVD**

Curtis Talley Jr., Farm Management Educator Michigan State University

MSU Extension has received numerous requests to have a recorded presentation of an oil and gas leasing program on [www.msue.msu.edu/oilandgas](http://www.msue.msu.edu/oilandgas). With the assistance of Department of Natural Resources Communications, a narrated slide presentation is now available. It is titled "New MSU Extension Oil and Gas Leasing Video." For those that do not have high speed internet access, a DVD is also available that can be ordered and sent to you from Curtis Talley. There is a \$10 charge.

## **OIL AND GAS LEASES: DON'T ASSUME YOUR TITLE IS "GOOD"**

Dave Porteous, attorney at law

Title review is an important step in entering an oil and gas lease. Oil and gas companies have traditionally conducted their title searches after signing the lease. The company usually pays out the "bonus" after receiving an opinion that the property has "marketable title." This ready-fire-aim approach helps speed transactions along, and reduces companies' costs.

Until recently, most people involved with the oil and gas industry understood that companies must follow commonly-accepted standards when evaluating a title's marketability. In particular, most understood that certain interests, like "current" mortgages, do not render a property's title "unmarketable."

These assumptions changed when some lessors cancelled large numbers of leases in Michigan's Northern Lower Peninsula in 2010 and 2011. These cancellations prompted over 100 lawsuits. The resulting court opinions teach us lessons about negotiating oil and gas leases.

Judge Philip Rodgers Jr.'s opinion in *O'Hair v Oil Niagaran, et al.*, Antrim Circuit No. 11-8645-CK, is particularly notable. The O'Hair family entered a lease agreement with OIL Niagaran, LLC (OILN). As is common, the lease and payment order gave OILN 90 days to review and approve title. OILN gave the landowners notice of nonpayment and refused to pay their bonus. OILN did not give the O'Hairs an opportunity to cure the "defects" it found. Judge Rodgers reviewed these "defects," and found them rather weak:

- OILN claimed a conservation easement on the property may have hurt its development potential. Judge Rodgers noted that the easement explicitly allowed oil and gas extraction and that it did not appear to require the easement holder's preapproval for the lessee's activities.
- OILN objected to a document signed by an owner's agent under a power of attorney, because it wasn't recorded with the register of deeds. Judge Rodgers noted that a simple document request by OILN would have likely resolved OILN's concern.
- OILN claimed that a co-owner's wife hadn't released her dower interest in the property. Judge Rodgers explained that the wife had no dower right, because her husband co-owned the leased property as a "joint tenant."

Nonetheless, the court found that the lease imposed little limitation on the lessor's right to reject a lease after the title review. Under the lease's terms, it was enough for OILN to have some concern that there could be litigation regarding the property's title.

The authors of this article are aware of recent contrary opinions from other Northern Michigan courts, but landowners should assume that the rules and lease terms lean in favor of the oil and gas company. Landowners can take some lessons from *O'Hair*:

- Do not assume that your lease gives you a chance to fix potential title defects. Your lease should explicitly force the lessee to give you notice of title defects, and give you time to cure them.
- If your property is mortgaged or subject to an easement (particularly a conservation easement), require a provision explicitly stating that that interest does not render title "unmarketable."
- Require upfront payment of the bonus.

Oil and gas leases are complicated legal documents. Title review is only one aspect. We suggest that landowners seek an attorney's advice when considering entering a lease.

***About the Authors.*** David Porteous and Nathan Piwowarski are shareholders at the law firm of McCurdy, Wotila and Porteous, P.C. Their firm has over 60 years' collective experience in negotiating oil and gas leases for Michigan landowners. Mr. Porteous recently gave a guest lecture for an oil and gas seminar sponsored by Michigan State University Extension.