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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.

**Please note that the MSU Extension Oil and Gas web site has a new address:
http://msue.anr.msu.edu/resources/oil_and_gas_development.**

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MICHIGAN STATE UNIVERSITY OIL AND GAS WEB PAGE HAS A NEW ADDRESS

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The web page for the site is now: http://msue.anr.msu.edu/resources/oil_and_gas_development.
If you have the old page address as a favorite, you can still go to that page and use a link to the new page.

Department of Environmental Quality Directory of Michigan Environmental and Drinking Water Testing Laboratories

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MSU Extension has received a number of requests to provide a list of licensed water quality testing laboratories in Michigan. The document "DEQ Directory of Michigan Environmental and Drinking Water Test Laboratories" is now on the MSU Extension Oil and Gas web site at http://msue.anr.msu.edu/resources/oil_and_gas_development.

Drinking water laboratories doing business in Michigan **are** required to be certified by the DEQ, WD (Water Division). The WD requires the certification of all laboratories that analyze the following:

- Drinking water samples under the Safe Drinking Water Act (1976 PA 399)
- Private water well samples under Part 201, Environmental Remediation, of the Natural Resources and Environmental Protection Act, 1994 PA 451, as amended (NREPA)
- Swimming pool water samples under the Public Health Code (1978 PA 368)

For further information about these laboratories, please contact the WD at 517-335-8319 or visit their Internet Web site at http://www.michigan.gov/deq/0,1607,7-135-3307_4131---,00.html. Laboratories must use United States Environmental Protection Agency (EPA) approved testing methods unless other methods have been approved by the DEQ.

Michigan Land Ownership Affects Who Can Negotiate and Sign an Oil and Gas Lease

Curtis Talley Jr. Farm Management Educator Michigan State University
Reviewed by Trent Hilding, attorney, Hilding Ag Services, Edmore, Michigan

How property is owned affects who has the rights to negotiate an oil and gas lease.

Joint tenants cannot negotiate their own separate leases. They must all sign the lease. If one refuses to sign, the lease will not be consummated, as all owners must agree. If a husband and wife own a property as joint tenants, it means that if one joint tenant passes away, the surviving joint tenant becomes the sole owner. Because the property is owned jointly, all joint tenants must agree to sign an oil and gas lease.

Divided, separate ownership: Let's say you own the surface estate of a property, along with 50% of the mineral rights. Joe retained 50% of the mineral rights when he sold the property to you. We have a situation where two people each own a divided 50% of the minerals. Previous surface owner Joe negotiates his own lease for his 50%. You and Joe each negotiate and sign

your own lease. You and Joe can also choose to work together and block up your mineral rights and negotiate the lease together and each sign an identical, separate lease.

A **tenant in common** negotiates his own oil/gas lease. Tenants in common can negotiate a lease for their proportionate ownership of the property. If two people own 80 acres as tenants in common, each owns 50% and each can negotiate their own separate lease. All 80 acres must be under a lease or compulsory pooling order to obtain the drilling permit to drill a well. One party cannot lease his 50% and get a well. Tenants in common are sometimes confused with joint tenants. There is a tremendous difference. In estate planning, regardless of what a person's will says, if that person owns a house or property as a joint tenant, the surviving joint tenant becomes sole owner of the property. If two people own land as tenants in common, each person's share becomes part of their estate at death. The estate plan for that person determines how their share of the property is distributed.

If a **Limited Liability Company (LLC)** owns property, the operating agreement should state which member or members have the authority to bind the company. If the operating agreement states that all members must agree to bind the company and all do not agree to lease the mineral rights, leasing will not happen. Or, certain decisions, such as binding the company may require a majority vote, it depends on what the operating agreement says. Additionally, they should have meeting minutes or a resolution approving entering into a lease.

Sometimes, one of the members is appointed manager, with the authority to bind the company. In that case, only the decision of the manager is needed to obligate the assets of the LLC for a loan, or in this case to sign an oil and gas lease. Here again, this should also be a topic of a normal company meeting and the decision documented by meeting minutes or a resolution. A manager can also be hired and be given these types of powers in the operating agreement. By the way, the LLC does not have to own property; it can be just be a "naked" operating entity.

Partnerships would be treated in a similar manner as joint tenants with all parties being required to sign. A Family Limited Partnership or Limited Partnership could have a General Partner negotiate the Lease without the requirement or say of a Limited Partner.

If a **corporation** owns mineral rights, the corporate by-laws should state who has the authority, or what method will be used to bind the corporation. The corporate by-laws are very similar to the LLC operating agreement. The same procedures and documentation is used by the corporation as the LLC.

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Highlights from the October 24, 2012 State of Michigan oil and gas lease auction

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The October 24, 2012 auction for the right to lease State of Michigan owned mineral rights saw 148,101 acres leased. This twice-yearly auction provides any qualified bidder the opportunity to bid for the rights to lease Michigan owned mineral rights using the State of Michigan lease. The acreage is nominated by members of the industry. All bidders have the ability to make the highest bid to successfully secure the rights to lease a tract.

There were six counties that exceeded greater than 10,000 acres leased. These were Iosco with 28,155 acres, Tuscola with 19,125 acres, Allegan with 12,349 acres, Oscoda with 11,039 acres and Saginaw with 10,182 acres. Counties with greater than 5,000 acres leased were Ionia and Kent.

The State of Michigan lease is available on the MSU Extension oil and gas web page. This lease is frequently available at landowner educational oil and gas meetings to take home and compare with the lease a mineral owner may be evaluating. The State of Michigan lease has many lease terms that are recommended in an oil and gas lease. The royalty to the State is 1/6.

If you would like a copy of the State or Michigan oil and gas lease go to http://msue.anr.msu.edu/resources/oil_and_gas_development, or contact your local MSU Extension office.

Southern Lower Peninsula continues to lead in oil and gas drilling activity

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Over the last couple of years, there has been a tremendous interest in leasing mineral rights in many areas of southern Michigan. During 2011 and 2012, Michigan State University Extension landowner educational meetings have been held in many counties in southern Michigan. According to the November issue of the Oil and Gas News, one of the more productive and successful geologic zones in production in southern Michigan have been the Trenton-Black River. The Trenton-Black River is a brown to gray crystalline limestone, with the productive

zones being dolomite (sedimentary carbonate rock). Dolomite has natural fractures, unlike the shales such as the Marcellus and Collingwood shales. These natural fractures allow oil and gas to travel to the well bore, so it does not need to be hydraulically fractured. In South central Michigan, both limestone and dolomite are present. According to industry sources, dolomite is treated with an "acid job" which is a means of cleaning out the wellbore path to allow the oil/gas to flow to the surface.

Crude oil production from the Trenton- Black River has bolstered the state's crude oil production capability. West Bay Exploration, a Traverse City based company has expanded its work in Calhoun and Jackson counties. For the first five months of the year it produced 813,277 barrels of oil.

Another Michigan based company, Savoy Energy, L.P. has had success in the development of the Adrian Field in Lenawee County. Lenawee and Jackson counties have helped it become one of the leaders in crude oil production in the state with a total of nearly 300,000 barrels reported for the first six months of this year.

Compulsory Pooling: How the Unleased Mineral Owner Gets Paid

Curtis Talley Jr. Farm Management Educator Michigan State University

The June issue of the Landowner Oil and Gas Newsletter discussed compulsory pooling in the article **Compulsory Pooling and the Landowner Not Willing to Lease.**

This issue discusses how the landowner is paid and how it is determined. Compulsory pooling does not happen often because it is an expensive process for the oil and gas development and production company to ask for compulsory pooling. They would much prefer a signed lease and a win-win lease agreement can be better for the landowner. In conversations with landowners, the author has learned that the threat of compulsory pooling is not uncommon if the mineral owner is unwilling to sign the initial lease (standard lease) offered by the company. Statements made by the company representative give some the impression that if they do not sign the lease offered, they will be forced to lease anyway by the state and it will be years before a royalty is earned. They feel they have no choice, so they give up and sign the standard lease. Numerous oil and gas attorneys that represent landowners believe the basic terms of a compulsory pooling order for the un-leased mineral owner that chooses to be carried by the company are preferable to the standard lease. Those terms are:

1. It will deal with only the well in question. Only the acreage you own necessary for the drilling permit for that well will be pooled, not the entire acreage you own.
2. "The nonparticipating owner of an un-leased mineral interest shall be considered to be subject to a 1/8 royalty interest which shall be free of any withholding for

payment of any costs of drilling, completing, equipping, or operating costs, including postproduction costs”.¹

3. It will be a non-development order. It will not establish any right for the operator to operate on your surface lands to place a well site, tanks, roads, etc.
4. You will receive no lease bonus because there will be no lease signed.

If the landowner owns all of the mineral rights, what happens to the other 7/8? It goes to the oil and gas company, but not as it would if there were a lease, because there is no lease, it is an order from the Supervisor of wells. The un-leased landowner is **treated like a working interest owner**. Working interest is a very important concept. A working interest owner is a partial owner of the well. Investors can buy an interest in the well, say 10% and receive 10% of the company's share of the income and pay 10% of the drilling, equipping and operating the well.

Under compulsory pooling, because the company is paying all of the costs to drill and develop the well, and they have the risk of a dry hole, the mineral owner is assessed a penalty, usually at least 200% of the costs of drilling, completing, equipping and operating costs to drill and develop the well, in addition to the actual costs. The penalty and drilling costs come out of the 7/8 stream of royalties the owner would have gotten as a **working interest owner**. After the well is paid for, the mineral owner receives the 1/8 cost free royalty, plus the percentage of the income and expense based on their ownership in the well. For example, if it takes 10 years of cash flow to reimburse the development company and pay for the drilling, development and penalty, in year 11 the mineral owner receives the 1/8 plus their share of the working interest. Because the mineral owner can eventually receive a royalty plus the working interest income, if the well is a good producer and long lasting, it is likely that a compulsory pooled mineral owner over the lifetime of the well could earn significantly more than signing the standard lease that offered a 1/8 royalty based on net income and its associated deductions for post-production costs.

¹ Order of the Supervisor of Wells (A) 16-12-03, February 9, 2004

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. Please go to the Michigan State University Oil and Gas web page to obtain specifics about a meeting, or contact the local extension office that is sponsoring the meeting. Upcoming meeting dates and locations:

Allegan County, January 9, 2013
Tuscola County, January 10, 2013
Missaukee County, January 16, 2013
Montmorency County January 29, 2013

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.