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Mineral Leasing 101

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Private landowners are sometimes faced with the confusing prospect of dealing with the development of mineral interests on their property. In the transfer of ownership of a property, landowners acquire a bundle of rights to that property. One way of looking at it is that with the deed, the owner gets a bundle of sticks, with each stick being a separate “right” to the property. Some of those rights are surface rights, hunting rights, water rights, right to enter, mineral rights, and others.

According to Oklahoma law, mineral rights can be severed from the land, meaning that when a person sells a property, the seller can retain the mineral rights, and the purchaser will own “surface and surface only.” Also, landowners can choose to sell their mineral rights at any time, or even devise the minerals to one heir, and the surface to another. How a landowner negotiates with an oil and gas company depends upon whether he or she owns just the surface rights, just the mineral rights, or a combination of both.

Surface Only Owners

Surface only owners have a difficult time preventing the development of the minerals under the property if the mineral owner has leased the minerals for exploration. But, surface owners are not without rights. Surface owners should always require:

- Payment for all surface damages

(including loss of acreage, usage of water resources, marketable timber, crops, electrical easements, pipeline easements, livestock, fences, ditches, harm to structures, and any other cost affecting the marketable value of the property).

- Clear guidance on how payment will be made – require a check and not a draft!
- Lessee to agree to restore the land to how it was before the Lessee came on the property.
- A bond to cover any future unanticipated damages.
- An alternative dispute resolution clause. Mediation and/or arbitration are much cheaper than a court dispute.
- Lessee to take all agricultural leases into account and hold the surface holder harmless, while indemnifying the surface holder from action by the agricultural leaseholder.

Surface only owners often feel that they do not have much bargaining power and that the oil and gas company is running over them. Please recognize that while surface owners may not be able to prevent drilling, they can certainly negotiate to minimize the damage and/or receive fair compensation for their harm.

The process usually begins when a landowner is approached by a land agent for the company. The land agent will

generally provide a copy of a surface damage agreement, and let the landowner know that a survey crew will be on the property in the near future. At this point, the owner can insist upon being present when the survey crew is there to help identify the least harmful place for the drill site to be located.

Once a survey is completed, the owner and the land agent will negotiate details. Owners should not be shy about asking to be compensated for anything that will reduce the value or their use and enjoyment of the property. Owners can negotiate for the company to put up fences, cattle guards, gravel on roads, road maintenance and any other things that may enhance their land holding.

To determine a reasonable base surface damage payment, owners should contact their neighbors to determine what others are being paid in the area. Because surface only owners will not be receiving any royalties on the minerals produced, this negotiation is the critical juncture for the owner to be made whole by the oil and gas company.

Mineral Rights Only Owners

Often, owners of mineral rights to a property who no longer own the surface are approached by oil and gas companies to lease their interest. These leases can be lucrative for the mineral owners, with a bonus lease payment at the time of leasing, and then royalty payments monthly if the minerals are developed.

If mineral rights owners no longer have any connection with the land or the current surface owners, their considerations in leasing are often focused mostly on their financial interest in receiving the highest possible price for their lease and royalty interest. However, mineral rights owners can negotiate to ensure that while being paid a premium to lease, they lessen impacts upon surface owners and the environment.

In most cases, mineral owners should not sign

the first version of the offered lease because the terms will be written for the benefit of the oil and gas company. Some issues mineral owners should look for in the language of proposed lease are:

- What minerals are being leased? Is it for oil, gas, coal, any mineral, or other specific minerals?
- What royalty interest is being offered? Many offer 3/16 with a bonus payment up front, but others may offer different amounts, like 1/8. Still others may offer as much as 1/4 interest if the owner is willing to accept some of the development risks/costs.
- How many acres are being leased, and are they measured as mineral acres or surface acres?
- How will royalties be calculated, and who bears the costs of production, transportation, marketing and taxation?
- Does the lease give the company rights to underground storage?
- Is seismic exploration allowed in the lease, and if so, and damages occur, how will they be calculated and paid?
- How long is the lease for, and what provisions are made for extension of the primary lease term should drilling occur?
- Does the lease make the minerals only owner liable to the surface owner for any damages?
- Does the lease address whether salt water injection will be allowed on the property, or other water usage issues?
- Can the lease be assigned by either party in the case of transfer of interests?
- Does the lease address road access, storage tanks, pipelines, and electrical easements, and, if so, are there provisions to allow for input from owner on placement of the same?

- Does the lease address pooling, allocations, or unitization?
- Does the lease seek to have the owner warrant title and defend ownership?

Always limit what minerals are being leased.

Some leases are liberal in their scope and provide that the contract covers all minerals and other gases and their vapors. Owners should not accept this kind of language unless they are certain that they are being fairly compensated for it. Instead, they should ask the land agent what type of minerals the company is interested in developing, and limit the language to that mineral only. That way, owners may still lease for other minerals to that company, or to another, for a new premium that is more to their benefit.

The amount of royalty that owners should ask for depends upon what the going rate in the area is and how the individual owner weighs interest and risk in revenue. A middle of the road royalty is about 3/16 of the profits from the minerals, and with that royalty, the owner should not expect to share in the cost of production, and should be able to receive a premium for per acre lease rental. Some companies offer 1/8, which is low and not as attractive – particularly if the minerals turn out to be very valuable – because the owner’s royalty payment will be low. A lucrative figure if minerals are produced is 1/4, meaning the owner would get paid 1/4 of the profits, but many companies won’t negotiate for this rate unless the owner is willing to accept a smaller lease rental fee.

Some companies measure the lease rental fee in surface acres, and some measure it in mineral acres. While surface acres are easily defined by a survey, mineral acres are estimated by a company geologist based on the amount of mineral resources that is assumed to exist beneath the surface of the earth under the property. Be aware of what type of measurement the lease is based upon.

If possible, negotiate to NOT be responsible for any of the production costs. This includes that the company not be allowed to use gas or oil from the drill site to run any motors at all. The rationale behind this suggestion is that the owner should be paid for the minerals from the wellhead, and not after some of the minerals have been used for costs that the company should cover.

In most leases, the duration for the lease is listed between two and four years. That period of time is called a “primary” term, and the lease payment that the owner receives is to cover that time period. If production is not established during that time period, the lease ends, and the owner will be free to lease the property again for a new fee to whoever he or she wants. But, if production was established during that time period, the lease will continue into a “secondary” term and last for as long as the minerals covered in the lease continue to be produced. The owner should try to negotiate to keep the primary term in the lease as short as possible, and then watch closely the expiration date of the lease.

Be very aware of whether the lease makes the mineral owner liable to the surface owner in any way, and avoid those terms under any circumstances. Those costs can be extensive and should be borne by the company because it is making the greatest amount of profit from the minerals.

The lessor has the strongest ability to protect the environment when entering into a mineral lease. Please consider refusing to allow salt water injection into the ground, even when encouraged to allow it by the company. Any potential harm to the water table, drinking water sources, and aquifers is too much, and should be avoided.

An assignment clause allows one or both parties to assign their interest in the agreement to a third party. The owner may consider disallowing or limiting the assignment rights of the lessee by requiring adequate notification in written form prior to an

assignment. The danger in assignments is that while the owner may be comfortable with the company that he or she is dealing with at leasing, a new company may not be as willing to work with the owner, or may not be as financially secure.

The owner can negotiate terms in the lease to offer control over roads, easements, storage tanks, and pipelines to the surface owner. This is one way that the mineral owner can make a significant non-financial contribution to foster good will with the surface owner, who will be burdened by the development of the mineral owner's lucrative minerals. A surface owner can minimize the impact of a drilling or mining operation if the mineral owner negotiates terms in the lease which require the Lessee to work with the surface owner on where to put roads and easements and such.

Oklahoma is subject to compulsory "pooling," which gives the lessee the right to consolidate the leased premises defining each landowner's interest in a common underground reservoir of minerals. Always try to negotiate the inclusion of a "Pugh" clause, which would allow for the severance of the lease into separate tracts whenever less than all of the premises are included in a single pool. An attorney can provide language to include.

Do NOT warrant or defend title. This provision is usually found at the bottom of the contract before the date and signature lines. Always mark through it with a pen and initial beside it, proving the intent to strike that clause. If the owner warrants or agrees to defend title, then he or she will be held financially responsible for legal fees that may arise if anyone else for any reason – valid or not – makes claim on the mineral rights. Don't do that!

Owners of Both Surface and Mineral Rights

If fortunate enough to own both the property and the mineral rights, the owner should consider everything written above, because it all applies. His

or her perspective will be different, but the same principles apply. Mineral production can be messy and take a long time. Negotiate the lease to reduce the impact to the owners', and neighbors', day-to-day lives. But remember, the owner can actually improve infrastructure on his or her property with well-negotiated language in the contract. A few things that owners may want to consider in addition to the issues above follow below.

- Do not allow production of minerals within 500 feet of any water source (ponds, lakes, rivers, and streams).
- Require that any machinery operated near a residence or office utilize hospital grade mufflers or other noise saving devices, such as fencing and barriers.
- Require that roads meet the owner's specifications and be properly maintained. Specifications may include paving, gravel, gates, cattle guards, culverts, etc.
- Limit access to other areas of the property.
- Require insurance and appropriate bonding.
- Require owner approval for placement of any roads, easements, storage tanks, or other appurtenances.
- Require immediate remediation of any environmental harm or hazard.
- Require landscaping to minimize appearances.
- Require fencing to protect livestock and children.

Form a relationship with the land agent as well as anyone connected with the construction of facilities and development of your resources. And again, talk with neighbors to see what they have been successful in negotiating. The end result of a strong lease could mean improved access to the property, royalty income, and many other intangible perks that come with having an improved infrastructure. Good luck!