

Oil and Gas Leases—Considerations Before You Sign a Lease Agreement

Dean W. Ginther
Elk-Skegemog Lakes Association (ESLA) President
May, 2008

Today I received a call from a concerned ESLA member on the west side of Elk Lake who reported that representatives (“landmen”) from a company called O.I.L. were contacting riparian property owners and encouraging them to sign gas leases. The O.I.L. landmen reportedly are contacting riparians and offering lease agreements which include acquiring the mineral rights to “all riparian or submerged lands” associated with waterfront parcels. These typically small waterfront parcels then can be aggregated with larger backlot parcels to form bigger groupings of adjacent property leases needed for efficient development. These leases may also contain provisions for automatic renewal of the lease agreement after the initial three year period, so such agreements could apply for decades into the future.

About three years ago, my wife and I similarly were approached by landmen from the Jordan Exploration Company. We live on the east side of Elk Lake and own both lake frontage and nearly 50 adjoining acres. At first, we ignored the calls and contacts. Although we knew very little about gas extraction or leasing, we did know that neither of us was interested in jeopardizing our beautiful property or permitting intrusions that would compromise our privacy and security. Nonetheless, the contacts from the landmen continued and eventually we decided to allow them to make a presentation. It was our goal to become better informed and, in particular, to ask questions about any possible risks or downside. During their visit with us, the landmen portrayed a picture that involved very little risk combined with an initial signing “bonus” and the potential of a consistent income for a period of fifteen or more years.

Should we sign a lease surrendering the mineral rights to our property? Did we know enough? For example:

- How would giving up our mineral rights affect the value of our property? Would giving up our mineral rights affect our children’s options when they inherited our property?
- If a well was drilled on our property, where could and would it be placed—could it be placed near our house or lake frontage?
- Would signing a lease allow access to our property without our permission or prior knowledge?
- Could an easement road or roads be built on our property?
- If a well was drilled on our property, how much area would be needed for the well?
- If there were any wastes or by-products associated with drilling or operating the well, where would they be disposed?
- How dangerous are such wastes and would there be a risk of contaminating the ground water on our property?

- Even if a well was not placed on our property, could one or more pipelines be constructed traversing our property?
- If pipelines were constructed, how much damage would there be to trees and landscape?
- Would we be reimbursed for such damage?
- Could wells on nearby property be “slant” drilled so that gas and other minerals under our property could be extracted without our permission and without any reimbursement?
- Were we being offered a financially “good deal” or were we being taken advantage of by the terms or the lease?
- Could a well located on our property be slant drilled so that it would terminate underneath the bottom lands that we “owned” on Elk Lake?
- Could the water quality of Elk Lake be threatened or affected by adverse events associated with nearby drilling and extraction?

We began to search for additional information that would help us resolve some these unanswered questions. We conducted Internet searches. We learned that there is a geological formation in six counties in Northern Michigan called the Upper Devonian Antrim Shale which is a source and reservoir for a sizable regional gas accumulation that is estimated to contain 4.45 trillion cubic feet (TCF) of gas. Typical well depths to recover this gas are between 1200 to 2200 feet below the surface. We knew that gas and oil drilling is regulated by the State of Michigan and that, in spite of those regulations, there were several improperly drilled gas wells in the Williamsburg area near the south end of Elk Lake during the 1970’s which resulted in significant environmental damage and loss of property. We learned that gas well drilling is a multi-step process that involves exploration, well drilling, production, and abandonment. We also learned that all stages of this process produce wastes that require proper management and disposal. We learned that the State of Michigan in 1979 permitted 13 slant oil and gas wells to be drilled beneath the bottomlands of Lake Michigan and that seven of these are still producing as of 2002. Also in 2002 and in spite of opposition from then Governor Engler, the Michigan legislature passed a permanent ban on Great Lakes drilling for oil and gas. However, we could discover no information that indicated it was illegal to slant drill under inland lakes if all other legal requirements for drilling were being followed. The Michigan Bar Association provides an information resources site on oil and gas legal issues at <http://www.michbar.org/generalinfo/libraries/lib10.cfm>. The State of Michigan also provides information about oil and gas wells at http://www.michigan.gov/deq/0,1607,7-135-3311_4111_4231---,00.html.

While this information was helpful, it did not address many of the specific questions we had regarding our property. After some additional searching, we found Susan Hlywa Topp, who is the principal of Topp Law PLC in Gaylord, Michigan. She focuses her practice on environmental, natural resource, real estate development and gas/oil matters in Michigan (see <http://www.topplaw.com/attorney.htm>). Before going into the practice of law, she was employed for 12 years as an Environmental Conservation Officer with the Michigan Department of Natural Resources.

By consulting with her, we were provided with the essential information we needed to make a decision. We learned from her and other sources that:

Giving up the mineral rights (severing mineral rights) to our property means that the owner of those rights has not only the ability to develop the minerals below the surface but also to do what is necessary on the surface to access any minerals below. These rights may include locating access roads on the surface, burying pipelines near the surface, depositing some types of waste, such as brine, on the surface or back into the well, deducting production costs from royalty payments, selecting the well location (within spacing and setback regulations), determining the depth and direction of the well, clearing (typically clear cutting) a section of the surface for drilling and access, retaining access to the mineral rights for 20 years or longer, and accessing the property whenever necessary and without prior notice. We also learned that “signing bonuses” are one time only payments, rates for royalties are negotiable, that we would not receive any royalty payments unless gas was produced, that payments could last for only a short period, and that such payments would be small. We were informed that the typical mineral lease includes rights to access not only gas and oil from the targeted geological deposits but also other deposits below or above the targeted source. We also learned that it would be difficult to prevent a development company from slant drilling under our surface property even if we had not surrendered our mineral rights to that company. Most importantly we were advised that it is very difficult to “undo” a mineral lease agreement once it has been signed; that “non-development” agreements can be negotiated, that liability for possible environmental or ecological damage and consequent property devaluation may not be clearly addressed in leases, and that simply surrendering the mineral rights for a property could lower the resale value of the property by 30% - 50%, depending on the location, value, and type of property.

Here’s the bottom line— be skeptical and conservative. Prior to surrendering the mineral rights to your property, make sure you are fully informed and knowledgeable. Consider consulting with a qualified attorney, preferably one who specializes in oil and gas law, who has experience representing property owners, and who is knowledgeable of environmental regulations. Be wary of signing a lease prepared by the development company. The company may be willing to modify their existing lease, but the standard lease offered by the development company will not protect your interests as well as one reviewed by a knowledgeable attorney on your behalf. A good attorney will write an addendum to that lease which will protect your interests.