

Oil and Gas Lease Language

Things to Consider Before Signing a Lease

The recent increase in well drilling within Geauga County has caught the attention of residents and local governments and raised concerns about the potential environmental impacts associated with well drilling and the implications of lease language agreements. Landowners regularly contact, and are contacted by, oil and gas well producers to drill wells on their property. A landowners' best defense is to include all concerns pertaining to property, mineral rights, and resource protection in a lease agreement.

Seeking Legal Counsel:

All prospective landowners considering the installation of an oil and gas well are essentially leasing their mineral rights to a producer. A lease maps out the terms and conditions which solidify the partnership between the landowner, or lessor, and the producer, or lessee. A lease is a legal and binding document that, if executed wisely, will protect the property and landowner for the life of the well. Contacting an attorney experienced in oil and gas well lease agreements will ensure that the language in the document will satisfactorily meet the needs of both the lessor and the lessee.

Landowners interested in having an oil and gas well installed on their property will work closely with a landman. A landman is the individual responsible for purchasing leases on acreage that an oil company thinks may contain oil and gas. A landman may or may not be independent. An independent landman will assign an oil and gas well lease to another company. Landowners should obtain references and background information on landmen and the companies they represent before agreeing to terms and conditions in a lease. Lessors may also want to consider the following before establishing the conditions of the lease:

- Can a higher rental payment be received while the well is actively drilled?
- When does the company intend to start drilling?
- Can the terms of the lease be renegotiated at any time?
- What is the primary term for the lease?

Many leases contain a clause that allows the producing company to assign or sell your lease to other firms. Be sure that the language established in the original lease will apply if the lease is reallocated to another company.



Site assessment:

Landowners should discuss any and all property damage that may occur to crops, fences, trees or other property assets and provide a resolution of damages in the lease language, should any occur. In addition, landowners should know how much and which parts of their land will be used for access, drilling, production, pipelines, compressors, and short or long term storage or equipment. Finally, landowners should inquire about directional drilling (defined below).

Leases should include language requiring the leaseholder to comply with all local requirements or recommendations of the most recent version of the following:

- *“Gauga County Water Management and Sediment Control Regulations”*
- Riparian and Wetland Setbacks as required by Subdivision Regulations or Local Zoning Requirements
- Floodplain setbacks through local building codes
- Noise Control through local Zoning Requirements

It is strongly encouraged that a copy of the regulations listed above are inserted into the lease agreement.

Definitions:

Cash Bonus - An up-front one time payment paid upon signing the lease or prior to commencement of drilling the well.

Primary Term - The number of years that a lease is in effect before drilling occurs. This is usually no more than two (2) years.

Secondary Term - The length of a lease after a well is drilled, usually lasts as long as the well produces a commercial quantity.

Pooling or unification - A provision that allows the lessor's land to be combined with adjoining lands to form a drilling unit.

Delay Rental - Annual rental payments paid to the lessor after the first year of the primary term, usually on a per acre basis.

Royalty - The share of production from your property. In a lease, this is referred as a fraction, usually 1/8 of the value of the oil and/or gas produced and sold.

Shut-in Royalty - Payment in lieu of a production royalty. Paid when a well is “shut-in” (capable of production, but no producing), for maintenance or other reasons.

Termination - Occurs when the primary term expires or when economic production ceases during the secondary term.

Free Gas - An annual allocation of gas to the lessor for domestic heating purposes. This is commonly 200,000 cubic feet or more per year and goes to the person upon whose land the well is located.

Directional Drilling - Drilling that is not directly vertical. The drilling direction changes to horizontal drilling to better locate the oil and/or gas product.

Oil and Gas Lease Language

Things to Consider Before Signing a Lease (Cont'd)

Productivity:

A "free gas" provision may be included in the lease language. Free gas is an annual allocation of gas to the lessor for domestic purposes. Should gas usage exceed the amount of gas stated in the lease, the lessor should be able to purchase additional gas at the current well head price.

The lessor must also consider what will happen to the well once it is no longer economically viable for an oil and gas well company. Often times the well can still supply the needs of domestic uses. If this is the case, the landowner/lessor may consider assuming ownership of his/her well. Once ownership is assumed by the landowner, plugging the well is now the landowner's responsibility if and when the well no longer produces.

Near the end of a well's life, gas companies may operate the well only one day per year to meet ODNR requirements for active wells so that they do not have to cap the well and reclaim the site. Lessors should specify in their lease agreement that the lessee provide an annual financial statement indicating production and net operating expenses. In addition, the lease should stipulate that the document becomes null and void if the well is not economically productive in any two (2) consecutive years. If a lease is voided, ODNR can order the driller to plug the well and reclaim the site.

The landowner's/ lessor should reserve the right to examine all production records, charts, meter readings, gas sales contracts, or any other data connected with the well's production and revenues.



Restoration:

The lease should also include language specifying standards for site reclamation after the well has been installed and plugged.

The lessor should reserve the right to purchase the well at the time the lessee desires to abandon it, including a clear methodology for determining residual value written in the lease.

The lessee should and can be required to restore the property disturbed by drilling operations as close to its original condition as practical.

Before signing a lease, any landowner considering the installation of an oil and gas well should seek legal council.



Information for this publication taken in part from A Landowner's Guide to Oil and Gas Leasing published by NY State DEC, Landowners and Leasing for Oil and Gas in Ohio published by ODNR-DMRM, Drilling for Oil and Gas in Northeast Ohio published by The Research Group, Inc., Chap. III Tips for Landowners, Oil and Gas at Your Door?, published by Oil and Gas Accountability Project.

References:



ODNR-Division of Mineral Resources Management

2045 Morse Road-Building H-3
Columbus, Ohio 43229-6693
614-265-6633
www.dnr.state.oh.us/mineral/oil/index.html

Ohio Oil and Gas Association (OOGA)

1718 Columbus Road SW (St. Rt. 16)
P.O. Box 535
Granville, Ohio 43023
740-587-0444
www.ooga.org

New York State Landowner's Guide to Oil and Gas Leasing

www.dec.state.ny.us/website/dmn/brochure.pdf

Drilling for Oil and Gas in Northeast Ohio—A Landowner's Guide and Due Diligence Checklist

Christopher Eiben

Oil and Gas at Your Door? A Landowner's Guide to Oil and Gas Development 2nd Edition

Chapter III-Tips for Landowners
Oil and Gas Accountability Project

Negotiating Oil and Gas Leases on Indiana Farmland

Gerald A. Harrison

Prepared by:

Geauga Soil and Water Conservation District
14269 Claridon-Troy Rd.
P.O. Box 410
Burton, OH 44021
Phone: 440-834-1122
Fax: 440-834-0316
Email: gswcd@geaugaswcd.com

Geauga SWCD Mission:

"To conserve, protect, and enhance the resources of Geauga County by providing leadership, education, and assistance to all."