

Purchase of Unproductive Well

The company has the responsibility to plug a well according to Ohio law. Occasionally a well stops producing in "paying quantities", but still produces enough gas to heat a residence. A landowner can negotiate with the company to assume this well along with all future costs and liabilities. This includes the cost of plugging the well, which can be several thousand dollars. Requirements of plugging a well should be reviewed before assuming responsibility.

Reclamation of Well Site

The lease should include a reclamation clause stating that the land is to be restored to its original condition. According to Ohio law, reclamation of land that is not required in the production of a well must occur within nine months after drilling is commenced. If a well is to be plugged, the company has six months after plugging for reclamation and removal of all drilling equipment from the property. If reclamation has not been completed within the allocated time frame, a complaint can be made to the Chief of the Division of Mineral Resources.

Conclusion

Before a landowner signs an oil or gas lease, he/she should recognize that upon the signing of a lease the landowner and drilling company become partners. A constant dialogue and true understanding is necessary for a happy and successful partnership. Get everything in writing and keep the lease in a safe but easily available place. In the event the lease is lost, a copy can be secured from the county recorder's office.

Farmers should enter the agreement with their eyes wide open and only after careful consideration and legal advice. Landowners have in fact lost money in leasing their farm for oil and gas. Do not be overcome by eagerness to lease or the aggressiveness of an oil man. The lease follows the land and can last decades and beyond. It is to both parties' advantage to maintain a friendly but business-like relationship.

Review the lease carefully and ask questions about those portions not understood. Keep in mind each company may use a different lease form on which a farmer, with the help of an attorney, can make adjustments to fit his farm. Be sure blanks are filled in legibly and with words the landowner understands. Ask for five references from the company of landowners where they have operated wells. Call the references and ask: (1) Is the producer easy to talk to and does he or she respond to problems promptly? (2) Are delay rentals or royalties paid regularly and on time? (3) Were you consulted on access road, well site and facility locations? (4) Was restoration done properly? (5) Are you having any problems now with the producer?

Ask neighbors, the Ohio Farm Bureau, the Division of Mineral Resources at the Ohio Department of Natural Resources or the Ohio Oil and Gas Association about the company proposing the lease.

It is important the landowner makes sure he/she knows who he/she is dealing with before he/she enters into a lease. Check out the references of the company. Have an attorney experienced in oil and gas matters review the lease to evaluate it and make recommendations.

Be Aware

Acceptance and cashing of a lease fee after the original term can automatically renew a lease. Take steps to clear the record at the county recorder's office if a lease expires. Strike any automatic renewal clauses for a lease that is not producing. When a landowner signs a lease, he/she should insist on a certified copy, properly witnessed, notarized and recorded.

Get Acquainted

The landowner should get acquainted with the drilling contractor, drillers and well operator. The landowner should, if and when an operator moves onto his/her farm to drill, make himself or herself known to the drilling contractor and assist him in conducting his/her operations so as to protect the landowner's interest in his cattle, crops, access roads, water, etc. Most operators wish to maintain friendly relations with the landowner and will comply with all reasonable requests of the landowner. In the event workmen violate the lease or agreement with the contractor, ask him to stop work and contact the oil company or contractor immediately.

This brochure is meant to be an educational tool and should not be perceived as legal advice.

If you feel that you need more information regarding an incident involving Oil and Gas Leasing, please contact an attorney.

Other Resources:

Ohio Department of Natural Resources
Mineral Resources Management

2045 Morse Road
Building H-3
Columbus, Ohio 43229
(614) 265-7998

Oil and Gas Association
1718 Columbus Road
Granville, Ohio 43023
(614) 587-0444

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A Landowners Guide to Oil and Gas Leasing in Ohio



Introduction

Oil and gas drilling is increasing in Ohio. This increase is driven by the increase in the demand and price on all sources of energy.

Before an oil and gas producer can drill, deepen, convert, plug back, plug and abandon, or reopen a well, he must obtain a permit from the Division of Mineral Resources at the Ohio Department of Natural Resources.

Prior to obtaining a permit to drill an oil or gas well from the Division of Mineral Resources, an oil and gas producer must obtain permission from the landowner(s) to enter the land. This permission from the landowner(s) is in the form of a lease agreement. LEASES SHOULD ALWAYS BE IN WRITING.

Every effort should be made to negotiate terms of the lease agreement that are fair to both the landowner (s) and the oil and gas company. Following are some lease terms that should be considered when negotiating a lease.

All Leases are Negotiable

Leases should be written to fit the specific need of the parties. Leases should always be in writing; oral promises are unenforceable. A lease agreement should be reviewed by a qualified attorney before signing.

Identification of Parties

The lessor is the owner of the minerals to be extracted. Every person that has an interest in the property needs to sign the lease. The lessee is the company that is interested in obtaining the rights to drill and produce the oil and gas. The lessee is not always the same company that develops the site.

Purpose of the Lease

The oil and gas company often wants very broad language to allow access to the total property without further landowner notice or permission. These are commonly called "farm wide" leases and can lead to multiple wells, pipelines, storage units, roads, etc. without the landowner's consent. It is generally desirable for the landowner to limit the scope of the lease so that additional wells, pipelines, structures, etc. requires further negotiation. At the very least, the point of entry and location of any structures should require the approval of the landowner. Landowners should avoid language like "all other minerals"; "transport from, across, and through"; "by any means"; or "storage of oil gas or brine from any other land". Also, the leased unit should be as small as possible so that the landowner can lease additional well units.

Terms of Lease

Leases have two possible points of termination: the end of the primary term and the end of the secondary term. The primary term is the period of time before drilling starts. This is a stated period of time and can last from a few months up to ten years, with two to five years being common. From a landowner's perspective, the shorter the primary period, the better.

The secondary term of a lease commences when a well produces in "paying quantities" and runs indefinitely while the well is active. The secondary term does not commence if the well does not produce. If a well is unsuccessful, it is common to allow the company enough time to commence a second well. Once again, the shorter the time period, the better.

Lease Payments

Usually the landowner is offered \$1 at the time of signing a lease. Depending on the demand for drilling locations in the area, it is not uncommon for the company to pay a "signing bonus". This amount varies from site to site and is generally used to cover the time and expense of having the lease agreement reviewed by an attorney.

Delay Rental

A delay rental is generally paid on a per acre basis and covers the period of time until drilling commences. It is to the landowner's benefit to have as much of the delay rental paid as early as possible. The amount of the delay rental varies depending on the demand for drilling locations in the area and the potential production of the well. The payment of a delay rental generally means that the company has an exclusive right to drill a well.

Royalty Payments

Upon the completion of a successful well, the lease agreement shifts into the secondary term and the landowner is paid a percentage of the production, commonly referred to as a royalty. One-eighth share has been common, but a skillful negotiator may negotiate up to a one-sixth share.

A royalty should be paid on all saleable products with copies of production and sales records provided. A remedy for delinquent payments should be included in the lease.

Free Gas

In addition to the monetary payments, a landowner normally receives free gas, often up to 300,000 cu. ft. per year. The provision to utilize this free gas is at the expense and liability of the landowner. Generally the use of free gas is limited to one residence; however, the ability to use free gas in the barn or for grain drying is beneficial to the landowner. The lease agreement should specify how much the landowner must pay for gas used in excess of the free gas allotment. The wellhead price is preferable to the retail price.

Shut-in Wells

Sometimes a well is capable of producing, but it is not economically profitable to do so. In this case, a well can be shut-in. The lease agreement should contain a shut-in payment, often the same as the delay rental.

Storage

A landowner should not allow for the storage of oil, gas or brine from another property without additional compensation. Storage does not have to be a part of the original lease agreement, but rather can be a separate business agreement.

Depth of Pipeline

Parties to a lease agreement often debate how deep a pipeline should be buried. The Division of Soil and Water at the Ohio Department of Natural Resources recommends five feet of cover. Four feet of cover may be acceptable in some places. A specific number should be stated rather than "below plow depth".

Damages

Older lease agreements regularly paid for damages only to growing crops. Modern lease agreements should require the company to pay for damages to growing crops, compaction to the soil for a period of years, timber, fences, roads, tile (for a specific number of years), water supplies, buildings and any other damage unique to the specific property.

Consolidation, Pooling and Utilization

This clause allows a company to combine an owner's land with a neighbor's land as a drilling unit. This means the royalty from the well is split among the landowners in proportion to the number of acres each contributes to the pool. The landowner where the well is located has all of the nuisances of a well while the production royalties are shared with neighbors. There are times when pooling is logical, sometimes even required by law. However, it is recommended that pooling provisions be stricken from the lease and that pooling provisions be separately negotiated.

Company's Right to Oil, Gas and Water

Typically, a company needs oil, gas and water to drill and operate a well. This is generally allowed without compensation unless the usage causes extreme hardship.

Assignment Renewal

Unless the lease says otherwise, the oil and gas company can assign the lease to another company. The landowner may want to maintain the right to deny assignment, or at least not unreasonably withhold consent, to ensure that the company receiving the assignment is satisfactory.

Sometimes a lease contains provisions that renew a lease for additional terms without the landowner's knowledge or consent. Landowners should be wary of these provisions because a landowner is prevented from leasing the land to another company while the lease is in effect. Furthermore, if a company leases a large tract of land and the drilling of a well is successful, the portion of the tract that is unnecessary for the well should be released by the company, or additional wells should be developed.

Identification and Attorney Fees

The company should be required to hold the landowner harmless from liability and any costs, expenses or liens from subcontractors. It is also recommended that the company be required to reimburse the landowner for any attorney fees required to be paid to enforce provisions of the lease.

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