

Oil and Gas Leasing in Ohio

Before oil and gas producers can drill, deepen, convert, plug back, plug and abandon or reopen a well, they must obtain a permit from the Division of Mineral Resources Management, Oil and Gas with the Ohio Department of Natural Resources (ODNR).

Prior to obtaining a permit, an oil and gas producer must obtain permission from the landowner(s) to enter the land. This permission 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 producer. All lease agreements should be negotiated, prepared and reviewed by a qualified attorney before signing.

Following are some issues and lease terms to consider when negotiating a lease.

Understanding the Parties Involved

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

Working with Old Leases or Several Mineral Interests

Leasing activity and the sale of mineral rights have been conducted in Ohio for decades. Some landowners know their property is covered by an old lease signed by a previous landowner. Others have found their property covered by an old lease established beyond the scope of, or otherwise not detected by the title search conducted as they purchased the property. Holding companies possessing these old leases could sell them to interested producers today.

Some holding companies could ask to make adjustments to key provisions of an old lease. Even lease adjustments should be discussed with private counsel. A landowner should consider whether the current lease fits their needs as well.

Landowners who are unsure whether their property is encumbered by an old lease should work with the county recorder or a title examiner to determine whether the lease has been terminated or released. If there is no evidence with the county recorder of the lease's termination or release, an attorney may be able to utilize the provisions of Ohio Revised Code 5301.332 to remove the old lease from the property.

A different problem occurs when mineral rights have been severed from the property. This may occur when a person sells property but reserves the mineral rights. Provisions of the Ohio Dormant Minerals Act, Ohio Revised Code 5301.56, may be used to declare the severed mineral interests to be abandoned and rejoin the mineral interests with the surface estate under specific circumstances. A landowner should work with private counsel if they are interested in pursuing this process.

Lease Provisions are Negotiable

Unless specified by federal and state law, all lease provisions are negotiable. Leases should be written to fit the parties' specific needs. Leases and all terms should be in writing; oral promises not included in the written lease are generally unenforceable. Ensure any promises made, and any changes, additions or deletions discussed, are included in the written lease before signing. Fill all blanks legibly, with words the landowner understands.

Purpose of an Oil and Gas Lease

The lessee often wants broad language to allow access to the property without further landowner notice or permission. These "farm wide" leases can lead to multiple wells, pipelines, storage units, roads, etc. on the property. The landowner should consider the impact of these types of provisions and whether further negotiation and compensation is needed for additional infrastructure.

Points of entry and location of structures are important terms to consider as well. The language of the lease will control both now and in the future, so expansive language like "all other minerals"; or "by any means" should be carefully considered with the assistance of private counsel. Keep in mind each company may use a different lease form on which a landowner, with the help of an attorney, can make adjustments.

Size and Scope of a Lease

In the 20th century, producers tapped 40-60% of the resources available in Ohio's geologic formations. Today, these formations are being revisited and new projects accessing deeper Marcellus and Utica shale are underway. Some landowners will work with companies using smaller, traditional vertical drilling technology; others will deal with companies engaged in larger, horizontal drilling projects.

Technology and leases have changed. No matter the size or scope of the operation, simple lease agreements do not cover today's financial, logistic, environmental and liability issues. Landowners should request and expect longer, detailed leases and realize the necessity of working with an attorney.

Terms of Lease

Leases have two possible points of termination: the primary term and the secondary term. The primary term is the period of time before drilling starts. This period can last from a few months to 10 years, with two to five years being common. Landowners generally prefer a shorter primary period. A lease may identify certain activities that extend the primary term. A landowner should clearly understand both the defined primary term and any possible extensions.

The secondary term of a lease begins when a well produces in "paying quantities" and runs indefinitely while the well is active. The secondary term does not begin 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 – the shorter the term the better. These terms should be clearly spelled out in the lease.

When the lease terminates, Ohio Revised Code 5301.09 requires the lessee to have the lease officially "released" in the records of the county recorder. If the lessee fails to do so, the landowner may follow the procedures in Ohio Revised Code 5301.332 to declare the lease forfeited.

Lease and Bonus Payments

Depending on drilling location demand, it is common for the company to pay a signing bonus. This amount varies from site to site and landowners should ask exactly what the bonus payment is intended to cover. Landowners should consider whether a bonus payment will compensate for the time and expense of attorney review, baseline environmental testing of the property's soil and water resources, hiring a financial planner and other expenses incurred during development. Bonus payments could also include an up-front per acre lease payment covering the entire primary term. Usually bonuses are one-time payments made only at the lease signing.

Lease payments are offered to the landowner in a fixed per acre amount. Lease payments can vary greatly and may be much larger than historical amounts.

Delay Rental

A delay rental is 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 greatly depending on demand for drilling locations and the potential production of the well. Delay rental payments generally mean the company has an exclusive right to drill a well.

Royalty Payments

Upon completion of a successful well, the lease agreement shifts into the secondary term. The landowner is paid a percentage of the production referred to as a royalty. A one-eighth share (12.5 percent) has been common, but given recent demand and interest, a skillful negotiator may negotiate a royalty well above that amount. A royalty should be paid on all saleable products (oil, gas, Y-2 class gas liquids, etc.) and provide production and sales records. Leases may also provide a remedy for delinquent payments.

Shut-In Wells

Given economics or logistics, there are times when a well is capable of producing, but it is not profitable to do so. In this case, a well can be "shut-in." The lease agreement should cover shut-in provisions, and speak to a shut-in payment. Shut-in payments are often the same as delay rental payments.

Free Gas

A landowner normally receives free gas, often up to 300,000 cu. ft. per year, in addition to payments. Provisions to utilize free gas are at the expense and liability of the landowner. Generally free gas use is limited to the residence where the producing well is located. The ability to use free gas for activities other than home heating can be beneficial. The lease should specify how much the landowner must pay for gas used in excess of free gas. Prices are usually indexed to the local natural gas utility rate.

Depending on well location, depth, pressure and presence of natural gas liquids, the landowner may not be able to receive free gas. In such instances, landowners can consider negotiating for ownership of an annual allotment of gas from the well to sell back to the producer. The landowner can use the proceeds to purchase appropriate fuel for home heating and other activities.

Depth of Collection Pipelines

Federal and state law regulate the installation of interstate transportation and public utility service pipelines, while different rules and individual lease agreements determine how deep oil and gas collection pipelines are buried on private property.

Ohio Department of Agriculture - Division of Soil & Water Conservation recommends pipelines be installed with at least five feet of cover. Landowners should be wary of ambiguous terms, such as “below plow depth,” and instead determine depths that accommodate subsurface drainage tiles and other on-site infrastructure.

Surface Storage of Equipment and Drilling Byproducts

Landowners should carefully consider any lease terms which allow storage of oil, gas or brine from another property. Storage does not have to be a part of the original lease agreement, but rather can be a separate agreement with additional consideration paid.

Property Damage

Landowners should consider terms which require the company to pay for damages to growing crops, timber, fences, roads, water supplies, buildings and any other damage unique to the specific property. Repair or remediation for soil compaction and subsurface tile damage could also be specified for a period of several years.

Consolidation, Pooling and Utilization

Under Ohio Administrative Code 1501: 9-1-04, producers must have adequate land area above a producing well to protect the integrity of oil and gas resources. Depending on the well depth, a formula determines the area of necessary land in acres.

Leases typically contain clauses allowing a company to combine several adjoining properties as a drilling unit. The royalty from the well is then split in proportion to the number of acres each landowner contributes to the pool. The landowner with the well located on their property must incur all the nuisance, but share production royalties. Leases could provide additional payment to the landowner with the well on their property.

There are times when pooling is logical, sometimes even required by law. However it is, pooling provisions can be removed from the lease and separately negotiated. All landowners involved in a potential pool are able to negotiate regardless of the number of acres they contribute.

Company's Right to Utility Access and Water

An energy producer needs public utility access to drill and operate a well. Landowners should negotiate lease provisions indicating how and where temporary and permanent public utility infrastructure will be installed. Additional compensation is negotiable if installation causes extreme hardship.

The drilling industry in Ohio has used hydro-fracture since the late 1940s. Many companies will purchase water from nearby municipal water plants and have it stored, filtered, recycled and reused on several area drilling projects. Landowners can consider negotiation for additional compensation if their property will be used for water storage. The lease should specify the type of storage technology used (open reservoir or tank farm) and the location on the property. Carefully consider provisions allowing access to “non-domestic” sources of water (springs, ponds, and wells used to access water for livestock and/or agricultural production) on the property, which could impede the landowner’s agricultural operation.

Assignments and Renewal Provisions

Unless stated otherwise, the lessee can assign the lease to another company. The landowner may want to maintain the right to deny assignment or at least the right to approval with an agreement not to withhold reasonable consent to ensure the company receiving the assignment is satisfactory.

Some leases contain automatic renewal provisions, which renew the lease for additional terms without specific consent or notice to the landowner. Landowners should be wary of these provisions because land cannot be leased to another company while the current lease is in effect. If a company leases a large tract of land and drills a successful well, the landowner can consider terms that would release portions of land not needed for the well.

Be wary of provisions allowing automatic renewal of the lease at the end of the primary term or that make it difficult for landowners to terminate the lease at the end of the primary term. Acceptance and cashing of a lease fee after the original term could automatically renew a lease depending on the terms of renewal. If the landowner receives a payment that seems unusual, such as a payment on an old lease or an old, inactive well, consult a qualified attorney before cashing or depositing the check.

Well Site Reclamation

Ohio Revised Code 1509.072 contains standards for reclamation after drilling. Reclamation of land around a project must occur within six months after drilling has commenced. The company has six months after plugging a well for land reclamation and removal of all drilling equipment. If reclamation is not completed within the allotted time frame, Ohio Revised Code 1509.32 allows for filing a complaint with ODNR Division of Mineral Resources Management. These laws set a reclamation schedule and minimum standards; however, negotiate and incorporate provisions to address specific landowner needs.

Negotiation Groups and Associations

Leases cover agreements between individual entities. Landowners joining negotiation groups and associations should determine how collective collaboration and membership adds value to the negotiation process. Landowners still need to assess their specific needs and have the ability to add their own unique provisions to a group negotiated lease.

Landowners should practice the same caution in joining a negotiation group or association as when engaging in direct negotiations with an oil and gas producer. Having individual legal counsel to represent their interests and analyze all documents is highly recommended.

Obtain References

Ask the company for five landowner references which have or previously had operating wells on their property. Call the references and ask: (1) Is the producer easy to talk to and responds to problems promptly? (2) Are delay rentals or royalties paid regularly and on time? (3) Were you consulted on the access road, well site and facility locations? (4) Was restoration done properly? (5) Are there any problems with the producer?

Finding the Right Attorney

It is critically important for landowners to secure professional advice and assistance before signing any lease. When looking for an attorney, look for one with oil and gas leasing experience. Begin by discussing the attorney's fee structure. A landowner's modest investment in attorney fees will often result in larger bonus payments, larger royalties, more favorable lease terms and more protections for the landowner and their property.

Conclusion

Landowners should recognize a lease as a partnership with the drilling company. Constant dialogue and true understanding is necessary for a successful partnership. Get everything in writing and keep the lease in a safe, but easily accessible, place. If the lease is lost, secure a copy from the county recorder's office.

