Mock Lease Negotiation and Leasing Essentials

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Mock Lease Negotiation

Scenario #1

Patti = Mineral Owner

Jared = Landman

Mock Lease Negotiation

Scenario #2

Patti = Landman

Jared = Mineral Owner

Mock Lease Negotiation

Provisions:

- **SPECIAL WARRANTY**
- **DEPTH CLAUSE**
- **PUGH CLAUSE**
- **SHUT-IN ROYALTY**
- **COMMENCEMENT**
- **INDEMNIFICATION**
- **USE OF SURFACE**
- **NO DEDUCTIONS:** It is agreed between the Lessor and Lessee that, notwithstanding any language herein to the contrary, all oil, gas or other proceeds accruing to the Lessor under this lease or by state law shall be without deduction, for the cost of exploring, drilling, completing, maintaining, operating, producing, gathering, storing, separating, treating, dehydrating, compressing, processing, collecting, shrinkage, transporting, marketing, or any other such expenses, loss or charges for the oil, gas and other products produced hereunder.

Mock Lease Negotiation

24 hours later….

Mock Lease Negotiation

NO DEDUCTIONS: It is agreed between the Lessor and Lessee that, notwithstanding any language herein to the contrary, all oil, gas or other proceeds accruing to the Lessor under this lease or by state law shall be without deduction, for the cost of exploring, drilling, completing, maintaining, operating, producing, gathering, storing, separating, treating, dehydrating, compressing, processing, collecting, shrinkage, transporting, marketing, or any other such expenses, loss or charges for the oil, gas and other products produced hereunder to transform the product into marketable form; however, Lessor's share of any such costs which result in enhancing the value of the marketable oil, gas or other products to receive a better price may be deducted from Lessor's proportionate share of production so long as they are based on Lessee's actual cost of such enhancements. Lessee agrees to provide Lessor with a summary breakdown of any such expense charged to Lessor. In no event shall Lessor receive a price that is less than the price received by Lessee.

Mock Lease Negotiation

We’ve got a deal!

8 “Essentials” for any Oil & Gas Lease

1. Determine Lessee – Landman/Broker may try to withhold for competitive purposes

2. Do your research:
   - Determine the rates and terms of leases in the area
     - Contact: County Clerk, Abstractors, NARO, CLO state leases, etc.
   - Seek additional offers – Are there other companies leasing in the area?
   - Speak with adjacent surface/mineral owners

3. Request multiple royalty options and corresponding bonus rates to consider (1/8th, 3/16th, 1/5th, 1/4th)
   - Consider your current needs. Is the bonus or royalty more important?
   - Consider activity in the area, will a well be drilled?

4. Negotiate for a higher bonus, if possible

8 “Essentials” for any Oil & Gas Lease

5. Term:
   - Avoid primary terms longer than 3 years
   - Avoid options to extend
   - In the event of an option:
     - Aim for 1 year, but limit option to no more than 2 years
     - Negotiate for option bonus at 125-200% of original bonus

6. Provisions to Strike:
   - Full Warranty (substitute Special Warranty)
   - Top Lease. Example: *If at any time within the primary term of this lease or any continuation thereof, Lessor receives any bona fide offer, acceptable to Lessor, to grant an additional lease (top lease) covering all or part of the afore described lands, Lessee shall have the continuing option by meeting any such offer to acquire such top lease. Any offer must be in writing and must set forth the proposed Lessee's name, bonus consideration and royalty consideration to be paid for such lease, and include a copy of the lease form to be utilized reflecting all pertinent and relevant terms and conditions of the top lease. Lessee shall have fifteen (15) days after receipt from Lessor of a complete copy of any such offer to advise Lessor in writing of its election to enter into an oil and gas lease with Lessor on equivalent terms and conditions. If Lessee fails to notify Lessor within the aforesaid fifteen (15) day period of its election to meet any such bona fide offer, Lessor shall have the right to accept said offer. Any top lease granted by Lessor in violation of this provision shall be null and void.*

8 “Essentials” for any Oil & Gas Lease

7. Additional Provisions:

- Special Warranty: Lessor only warrants title, by, through and under Lessor only
- No Deductions/Gas Enhancement
- Depth Severance
- Pugh Clause
- Shut-In Provision (no more than 2 cumulative years)
- Commencement of Operations
- Indemnification

8 “Essentials” for any Oil & Gas Lease

For Lessors who also own surface:

- If at all possible, negotiate to have all your surface provisions incorporated within the Lease Addendum.
- At minimum, include provision on Addendum that specifies Lessee contact Lessor, prior to commencement of operations, to negotiate and settle the use of surface, including any water available.
- Example surface matters to address: Payment of damages, location of drillsite, pipelines, fencing, salt water disposal, closed system, surface and ground water, maintenance, plugging and restoration, etc.

8 “Essentials” for any Oil & Gas Lease

8. Check Please! No bank drafts.

Lease Terms

- A multitude of factors determine lease terms to be paid in a particular area:
  - Commodity prices
  - Historical oil and gas production within the area
  - Terms paid by competitors in the area
  - Terms negotiated by mineral owners
  - Terms differ by prospect; as does geology, production volumes, etc.

Lease Offers

- Landmen will present lease offers through lease offer letters, phone calls, or email
- In general, their offer is based upon the terms provided to them by the exploration company
- Lease offers are always subject to change:
  - By direction of the exploration company
  - Through negotiations between mineral owners and the landmen
  - The commodity price environment
  - Terms offered by competitors in the area

Lease Offers

- The lease offer will include the royalty, term of the lease, and lease bonus per acre to be paid
  - Royalty rates can range from 1/8th (12.5%) to 1/4th (25.0%), with 3/16th (18.75%) being the most common
  - The term of the lease has two parts, the 'primary term' and the 'secondary term':
    - primary term is the time frame in which the Lessee of the lease (exploration company) has to begin commencement of drilling a well.
    - If a well is drilled, completed, and becomes a producer, the lease then enters the secondary term and remains in the secondary term until any producing well or wells, drilled off of the subject lease, cease production

Lease Offers

- For some time, the most common primary term offered has been three (3) years. However, in recent years, exploration companies have been requesting 5 year primary terms or 3 year primary terms with 2 year options to extend. If the option is exercised, the Lessee generally pays the same lease bonus originally paid for the 3 year primary term.

- There are several factors contributing to the request for 2 additional years:

  - Drilling rig availability

  - Length of time needed to put a prospect together

    - The time invested in landwork and logistics takes much longer than it did even a few years ago.

Final Steps

- Once a sufficient amount of leased acreage, also known as leasehold, has been acquired within the proposed unit, the exploration company will finish any regulatory obligations necessary (in Oklahoma: Spacing, Location Exception, Pooling)

- In general, once the loose ends are tied up, the exploration company acquires a permit to drill, schedules a rig, and begins drilling operations

NARO Housekeeping

- Certified Mineral Manager Program (CMM)
  - Two Levels
    - Associate: Ideal for those seeking to expand their knowledge base in order to better manage personal or family interests – requires 20 education credit hours to maintain certification
    - Professional: Geared towards those managing minerals in a business environment – requires 50 education credit hours to maintain certification
  - Review Course
    - Educational to attend (even if not taking the tests)
  - Exam
- NARO Publications

Questions?