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Royalties bring rights owners extra cash

By Jack Money
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Productive oil and gas wells make money.

But figuring out who gets the money, and why, can be a daunting task to the uninitiated.

So, *The Oklahoman* recently talked to industry experts to demystify the process and get answers to a few questions, such as, where or to whom does the money go, how much do they get and why.

The short answer is that most of it goes to lease holders who invest in drilling the wells. But money also goes in royalty payments to the people who own mineral rights under the land.

However, it is somewhat more complicated than that.

Jack No. 1
For the purposes of this story, assume I own an energy company and want to drill a well called Jack No. 1 in the mythical Okie field near Oklahoma City.

If I drill that well and it is a successful producer, I am going to want to get repaid for my expenses and make money too.

But if you own the land's mineral rights, then I have to negotiate with you before I drill because as a mineral rights owner, you are entitled to an income stream by way of royalty payments from a working well.

And I am going to want to hold that expense down as best I can. If I can't keep 75 percent of what the well makes in money, I probably won't want to do the deal, I'm told by the experts.

Still, the industry standard when a contemporary lease is negotiated dictates that I should be willing to pay you three-sixteenths, almost 19 percent, of income the well ultimately generates. And in some parts of the country, I might be willing to pay you as much as 25 percent.

But that doesn't mean each individual mineral rights owner will get that much money.

If there are 20 such owners in the area, then the income my well makes will be divided at least 20 ways.

And it gets even more complicated. If one of those 20 people owns mineral rights to half the land, that owner will get half the money. The other 19 will get cuts proportional to the land area of mineral rights they own within the well area.

Another complicating factor is that sometimes, mineral rights owners are different than people who own the surface land.

Law aimed to protect owners

Bruce Bell, chairman emeritus of the Mid-Continent Oil and Gas Association of Oklahoma, agreed to describe how the royalties system works.

When oil and gas exploration started in Oklahoma during the 1900s, negotiated royalties were something pretty new.

"Knowledgeable people would come out really well," Bell said, "while less knowledgeable people would get taken."

Oklahoma responded by adopting a state law requiring companies seeking leases to pay at least one-eighth of the income stream to mineral rights owners, Bell said.

These days, he said, mineral rights owners are getting better deals. Today's lease agreements not only define how much mineral rights owners will be paid in royalties, they also set out lease bonuses for those owners.

Early on, lease bonuses were fairly small because chances of finding oil, or later gas, were not that good. Now, they can run as much as $3,000 an acre in active exploration areas.

How it works

Royalty interest is something a mineral rights owner is entitled to when he or she leases land to an oil and gas company for a well.

Sometimes, mineral owners can be individuals. Other times, a mineral owner can be a company. And sometimes, it can be a government, like the state of Oklahoma.

Up to 25 percent of a working well's income can go to its mineral owners.

The remaining 75 percent of money from a well's income goes two other places, Bell explained.

Overriding royalties are paid to geologists, land men and anyone else who deserves a financial reward for their efforts related to the well. These interest payments usually consume a small amount of the remaining income stream.

What's left is called a well's working interest.

And that income is divided among investing partners who paid for drilling the well — in the case of Jack No. 1, myself and my partners, if I have any. If I pay 50 percent of that cost, then I'm entitled to half of the working interest income. Like contracts between my company and mineral rights owners, contracts between me and my partners dictate how that money is divided.

Bell said investing partners try to keep royalty payments — both to mineral rights owners and the overriding royalty recipients — to about 25 percent of a well's potential income.

"If it becomes any more expensive than that, then going ahead and doing the well becomes really very questionable,” he said.

Today's royalty owners

The National Association of Royalty Owners, based in Tulsa, represents thousands of royalty owners across the U.S. The group was founded in Oklahoma in 1980, said Jerry R. Simmons, the group's executive director.

Simmons and other industry experts told *The Oklahoman* that royalty amounts paid to mineral rights owners vary from state to state.

Still, royalty owners are getting better-than-average deals right now, particularly in hot exploration areas like the Barnett Shale in north Texas.

Tina Bonner, of Duncan — the association's national president — said most royalty owners today are 65 years old or older and use royalties to supplement their retirement incomes.

In presentations she and other association officials make, they recommend landowners know what mineral rights they own, know what is going on in areas where they own land, and — once lease negotiations begin — remember that everything in an oil and gas lease and division order is negotiable.

A royalty owner, she said, should make sure he or she is treated fairly once production from a well begins.

"Nobody wants the development more than most royalty owners,” Bonner said.