

Gas Exploration and Production: Issues for Forest Land Owners

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- This slide set is provided for informational purposes only. Nothing herein constitutes the provision of legal advice or services.

Title to Interests in Real Property

- Subsurface capable of being a separate estate from surface estate
 - Further subdivision
 - Oil & gas
 - Depth range
 - Coal bed methane
 - Minerals
 - Sand and gravel (as distinguished from crushed rock)
- Presumption that surface estate includes all subsurface rights

Relationship Between Surface & Sub-Surface Estate

- Dominance of surface estate (apparently opposite rule in Texas)
- Reasonable use of surface estate
 - accepted and prevailing method for mining of the particular mineral
 - any particular rights waived or reserved
 - Intent of parties
 - protection for residences and residential water supplies (inconsistent case law)
 - right to compensation for surface damages?

Extinguishment

- N.C.G.S. §1-42.1 through N.C.G.S. §1-42.9A
 - Compliance with statute
 - Constitutionality

Abandonment

- Mere lapse of time insufficient
- Nonpayment of ad valorem taxes insufficient taken alone
- Requires unequivocal acts of abandonment

Adverse Possession

- Not previously severed
 - Adverse possession of surface includes subsurface rights
- Previously severed
 - Adverse possession of surface **does not** include subsurface rights
 - Adverse possession of subsurface rights **does not** include surface rights
 - Surface activities to extract subsurface resources do not confer adverse possession of the surface

Adverse Possession

- Actual mining required to establish adverse possession of mineral estate
- Need not mine all possible types of minerals in property subsurface

Conveyancing

- Caveat emptor
- Covenant of seisin
- Lease versus sale
 - Look to substance not form
- Statute of frauds applicable to sales and leases of mineral rights and gas & oil rights

Questions

- Were mineral or oil & gas rights ever transferred?
- What rights were transferred?
- Were such rights ever relinquished or abandoned?
- Were such rights ever extinguished?

Condemnation

- Condemnation of surface includes rights to minerals, oil & gas, where such rights were not severed
 - Value of minerals, and oil & gas a factor in valuation
- Severed estates
 - Rights to minerals, and oil & gas not acquired by condemnation of surface
 - Severed estate in minerals, and oil & gas may be acquired by separate condemnation action

Partition

- Tenants in common in mineral, and oil & gas rights may have interests partitioned

Taxation

- Use of statutory method
- 'True value'

Evaluating Oil & Gas Lease Proposals

- Long term leases
 - Exploration phase
 - Production phase

Evaluating Oil & Gas Lease Proposals

- Due diligence
 - **Broker or Principal**
 - **Financial condition**
 - **Safety/environmental compliance record**
 - **Litigation history**
 - Registered to do business in North Carolina?
 - **NC Secretary of State - <http://www.sosnc.com/>**

The Leasing Process

- **Standard lease agreement**
No Such Thing!
- **The landowner addendum**
- **Lease governs entire relationship**
between the parties!

Threshold Issues

- **Does the landowner own the resource to be leased?**
- **What is to be leased?**
- **Is the lease compatible with future land use plans?**
- **Is the lease compatible with existing restrictions on land use?**

Existing Restrictions on land Use

- Leases
- Zoning
- Conservation easements
- Present use value (PUV) tax program
- Security Interests
- USDA/State conservation programs

Factors That Affect the Negotiation of Oil & Gas Leases

- **Amount of acreage**
- **Physical features of property**
 - Typography
 - Ease of access
- **Quality of the resource**
 - Dry gas or wet gas (natural gas liquids)
 - Helium content
 - Sour gas (sulfur compound content)
 - Oil

Factors That Affect the Negotiation of Oil & Gas Leases

- **Geological features of property**
- **Number of companies in area**
- **Other production/infrastructure in area**
 - Experienced labor force
 - Suppliers
 - Interstate pipeline capacity
- **Market for energy: gas in particular, and energy generally**

Factors That Affect the Negotiation of Oil & Gas Leases

- **Negotiating skills of parties**

- **Hiring an attorney**

- Experience with mineral rights/oil and gas leasing
- Comfortable working with your attorney
- Understand the basis of all fees charged by attorney
- Receive a written retainer agreement from your attorney
- Good standing with NC State Bar

Typical Lease Clauses and Terms

- **Parties to the lease agreement**
- **Property description**
 - **Guarantee of title?**
- **Length**
 - **Primary (exploratory) term:**
may start with an option
 - **Secondary (production) term**
- **Choice of law** [North Carolina]
- **Choice of forum (venue)** [Superior Court of county where property located]

Typical Lease Clauses and Terms

- **Arbitration clause**
 - Who pays?
 - How selected?
 - Compliant with state law?
- **Attorney fees clause (is it one-sided?)**
- ***Force majeure***
- **Indemnification**
- **Free Natural Gas**
- **Pugh Clause**

Typical Lease Clauses and Terms

- **Payment terms**

- **Royalty** [formula for calculating]
- **Bonus Payment** [signing bonus]
- **Delay Rental Payments**
- **Shut-In Royalty Payments**

Typical Lease Clauses and Terms

- **Payment terms**
 - Other payments:
 - Water
 - Storage
 - Gas
 - Water and fluid
 - Equipment
 - Waste
 - Transport of foreign gas

Typical Lease Clauses and Terms

- **Storage Rights**
- **Transportation of foreign gas**
- **Installation of pipelines and power lines**
- **Non-Disclosure (confidentiality) Clause**
- **Access to records/production audits**
- **Notice of sale of lease**
- **Drilling clause/Development clause**
- **Removal or forfeiture of equipment**
- **Insolvency/bankruptcy clause**

Typical Lease Clauses and Terms

- **Provision for removal of equipment**
- **Insurance: certificate of insurance**

Rights granted by landowner/limitations on rights granted

- Oil and gas/mineral estate
- Surface estate
 - What may be used
 - Notice
 - Indemnification
 - ‘No surface use lease’
- **Water**
 - **Ground**
 - **Surface**

Additional Considerations

- Rule of Capture
- Pooling/Unitization
- Increased real estate taxes
- Imposition of severance tax
- Provision for Project Failure/
Termination
- Taxes
- Recordation

Resources

- ARE Natural Gas Page
 - <http://www.ag-econ.ncsu.edu/gasleasing.html>
- DENR report – Session Law 2011-276
 - <http://portal.ncdenr.org/web/guest/shale-gas>
- SRSI Study (May 15, 2012)
 - <http://www.buffalo.edu/news/pdf/UBSRSI-Environmental%20Impact.pdf>