



OIL AND GAS CONTRACTS: ISSUES FOR LANDOWNERS

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OIL AND GAS CONTRACTS: ISSUES FOR LANDOWNERS

- Some objectives for today
- Oil and gas contracts and the need for legal counsel
- The Top 7 List of Hidden Legal Issues to Consider When Signing an Oil and Gas Contract
- Some final observations
- Conclusion



ISSUES IN OIL AND GAS CONTRACTS: THE NEED FOR LEGAL COUNSEL

- An oil and gas contract, properly written and equitable to both parties, is a comprehensive legal document.
 - Shorter does not always mean better
 - Lawyers do not “create complications.” Complications exist, with or without lawyers.
- An oil and gas contract is a long-term commitment, so a poorly written contract is more of a threat to your property rights than eminent domain ever will be.
 - Contract transfers property rights between the parties for a minimum of 5 to 10 years, maybe much longer
- In some states, oil and gas contracts are highly regulated by the state statutes, but not Michigan.

BEWARE

OF

THE LAWYER



DO I REALLY NEED AN ATTORNEY TO SIGN AN OIL AND GAS CONTRACT?

You do not need to consult an attorney about an oil and gas contract if you can answer "yes" to any of the following:

1. *"My children are raising my grandchildren to be brats and I look forward to haunting them all from beyond the grave."*
2. *"My business and personal philosophy has always been 'Ignorance is bliss.'"*
3. *"I love the smell of fresh courtrooms in the morning."*



ISSUES IN OIL AND GAS CONTRACTS: ISSUES AND ALTERNATIVES

- Oil and gas contracts and the need for legal counsel
- The Top 7 List of Hidden Legal Issues to Consider When Signing an Oil and Gas Contract
 - Some general issues are common to virtually all oil and gas contracts



ISSUES IN OIL AND GAS CONTRACTS: ISSUE 7 – LENGTH OF THE CONTRACT

- Issue: What is the length of time the developer will have use of the land and for what purposes?
- Primary term: Number of years D has to commence drilling a well and keep the lease in effect.
 - Usually 5-10 years – L usually prefers shorter period, D prefers longer
 - If “drilling commences” by end of the primary term, then the secondary term of contract begins automatically. Note: What does “drilling commences” mean?
 - Does contract include an extension clause for the primary term? On what terms – notice, rent, right of refusal, etc.?



ISSUES IN OIL AND GAS CONTRACTS: ISSUE 7 – LENGTH OF THE CONTRACT

- Issue: What is the length of time the developer will have use of the land and for what purposes?
- Secondary term: Begins when drilling commences and continues
 - “So long as oil and gas are produced in paying quantities”
 - “So long as operations are conducted”
 - “So long as a well is capable of production”
 - Small differences in contract language can lead to large differences in legal meaning – and to L’s and D’s rights under the contract



ISSUES IN OIL AND GAS CONTRACTS: ISSUE 6 – GRANTING CLAUSE

- Issue: What property rights are transferred (granted) from the landowner to the developer?
- Granting clause: Describes the extent of the property rights granted by L to D.
 - Specifies use rights for activities to (a) explore/evaluate resources, (b) produce/removal/sell resources, and (c) construct other facilities/structures necessary for production (can include surface rights and subsurface rights).
 - Specifies which natural resources D is permitted to remove and sell.



ISSUES IN OIL AND GAS CONTRACTS: ISSUE 6 – GRANTING CLAUSE

- Issue: What property rights are transferred (granted) from the landowner to the developer?
- Granting clause: Which use rights for activities are transferred by the contract? Some important considerations:
 - What surface activities are permitted under the contract?
 - What structures/facilities could be built on the surface under the contract?
 - What subsurface facilities could be built under the contract?
 - What is L's role in determining the location of activities or building of structures/facilities? Is L's consent required?



ISSUES IN OIL AND GAS CONTRACTS: ISSUE 6 – GRANTING CLAUSE

- Issue: What property rights are transferred (granted) from the landowner to the developer?
- Granting clause: Which natural resources are transferred by the contract? Oil? Gas? Minerals? All minerals? Some important definitions:
 - “Minerals” means the right to minerals themselves, not to soil surrounding the minerals
 - Statute MCL 324.6330 “Mineral’ ...includes every inorganic substance that can be extracted from the earth...whether it is solid, as rock, fire clay, the various metals and coal, or fluid as mineral waters. Mineral does not include oil or gas.”
 - But some courts have held a contract “of all minerals” to include oil and gas in some contexts.



ISSUES IN OIL AND GAS CONTRACTS: ISSUE 6 – GRANTING CLAUSE

- Issue: What property rights are transferred (granted) from the landowner to the developer?
- Granting clause: Which resources are transferred by the contract? Oil? Gas? Minerals? All minerals? Some important definitions:
 - “Common mixed sand or gravel” might not be considered a “mineral,” but pure white quartz sand might be.
 - If the contract is for “mining and removing ores and minerals,” then the parties might not intend to protect the surface soil from damage.
 - Lesson: *Minor* differences in wording can produce *major* differences in interpretation regarding the property rights transferred by the contract. The granting clause should be *narrowly* written to transfer *only* the rights intended by the landowner.



ISSUES IN OIL AND GAS CONTRACTS: ISSUE 5 – ASSIGNMENT CLAUSE

- Issue: Does the developer have the right to assign the contract to a third party?
- Assignment clause: Permits D to sell or transfer the contract rights to a third party. Thus, L could become involved with an unanticipated third party.
 - What if the third party defaults or refuses to comply with the contract?
 - Can L hold D liable if the third party defaults?
 - What is L's role in determining the identity of the third party? Is L's consent to assign required?



ISSUES IN GAS AND OIL CONTRACTS: ISSUE 4 – LIABILITY

- Issue: Is the landowner or the developer liable for damages or injuries associated with the operation?
- Liability scenarios:
 - Is L liable to D if L damages D's equipment/facilities?
 - Is L liable to D if a third party damages D's equipment or facilities? Uncle Fred (permission)? A trespasser?
 - Is D liable to L if D damages L's property (surface also)?
 - Is L or D liable if a third party is injured as a result of the operation? Uncle Fred (permission)? A trespasser?
 - Is L liable to an employee of D injured on L's property?
 - Is L or D liable for the cost of litigation with a third party?
 - Always have the contract reviewed by landowner's insurance agent before signing



ISSUES IN OIL AND GAS CONTRACTS: ISSUE 3 – LAND USE RESTRICTIONS

- Issue: Does the contract contain restrictions on the landowner's use of other land? What are the legal consequences of the contract for other land uses?
- Land use scenarios:
 - Does the contract restrict the landowner's use of the land for other purposes (e.g., hunting)?
 - Who is liable for violations of land use regulations caused by the project (e.g., zoning violations)?
 - Could the project affect land enrolled in USDA CRP or commodity programs? Who pays any penalties? Always see FSA or NRCS regarding program consequences.
 - What if operations affect water quantity or quality?



ISSUES IN OIL AND GAS CONTRACTS: ISSUE 2 – CHOICE OF LAW/VENUE

- Issue: Does the contract contain a choice of law or choice of venue clause?
- Choice of law clause: Requires that lawsuit between L and D be heard under the law of D's state
 - Case *might* be heard by a Michigan court, but court *must* apply the law of the D's state
- Choice of venue clause: Requires that lawsuit be heard by a court in D's state
 - Case *must* be heard by a court in D's state
- Legal alternatives:
 - Michigan choice of venue/law or additional compensation



ISSUES IN OIL AND GAS CONTRACTS: ISSUE 1 – TERMINATION CLAUSE

- Issue: Does the contract contain provisions regarding the termination of the contract by either party?
- Termination issues:
 - Does the contract specify events that permit D to terminate the contract? If so, is D liable for any remaining payments under the contract?
 - Does the contract specify L's rights of termination? How does L exercise these rights?
 - Is L or D liable for the cost of removing the equipment/facilities at the termination of the contract? How fast?
 - Does the contract specify that land must be restored to its original condition at termination of the contract? How fast?
 - If D defaults during life of the contract, what are L's rights?

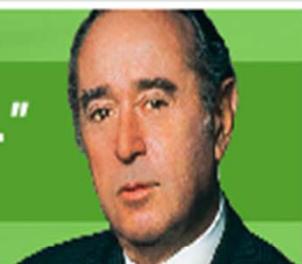


ISSUES IN OIL AND GAS CONTRACTS: CONCLUSION

- The landowner's contract will depend on
 - Geographic conditions beyond the landowner's control
 - Knowledge level beyond the landowner's control
 - Knowledge level within the landowner's control
 - Landowner's willingness to recognize *that complications exist, they are not created by attorneys*
 - Landowner's willingness to *invest* in the negotiation process
 - Landowner's willingness to *form a negotiation team* – legal, tax, insurance, FSA, NRCS, family, neighbors
 - Landowner's willingness to pursue *creative* negotiation strategies

"You don't get what you deserve, you get what you negotiate."

Dr. Chester L. Karrass



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"...you fail to see the limits of the other fellas power..."

**You don't get what you deserve, you
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