Oil and Gas 101

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Marcellus and Utica Shale Permits
(as of September 4th)

• Marcellus Shale permits/wells
  – 16 permits, 7 wells drilled
    • Focus is on Belmont and Monroe Counties

• Utica Shale permits/wells
  – 359 permits, 129 horizontal wells drilled
Ownership of Mineral Rights

• Prerequisite to entering into an oil and gas lease
  – Stay tuned for more information

• Importance of good title work
Oil and Gas Lease Terms

• Description of leased premises
  – Legal description vs. bounded by description
  – Mother Hubbard clause
    • No adjacent/contiguous properties
Oil and Gas Lease Terms

• Granting Clause
  – Grants the developer certain rights
    • Use of water, oil or gas from landowner’s property?
    • Disposal or injection wells?
      – Class II injection wells vs. oil and gas wells
    • Gas storage rights?
    • Roads and pipelines?
  – Identifies the minerals being leased
    • Only oil and gas (everything else reserved to landowner)
  – Reservation of shallow rights?
Oil and Gas Lease Terms

• Term Clause (aka habendum clause)
  – Establishes the duration of the lease
• Primary term of 5 years
  – Renewal option + new bonus payment
• Secondary term
  – Operations
  – Production in “paying quantities”
Oil and Gas Lease Terms

- $$$
  - Up-front, per acre bonus
    - Payable within 60-120 days
    - Conditions precedent to payment
      - Management approval (BAD!!!)
      - Title
    - Refundable?
  - Royalties (oil, gas, liquids)
    - Gross vs. net royalty
    - Market enhancement
    - Traditional (12.5%) vs. shale (more than 15%)
  - Shut-in payments
  - Free gas vs. Payment in lieu of free gas
    - Fixed amount, variable, royalty
  - Spud fee
Oil and Gas Lease Terms

• Unitization/pooling (combining tracts of land or leases for drilling wells)
  – Maximum size for horizontal and vertical wells
    • 40-160 acres (vertical well)
    • 640 or 1,280 acres (horizontal well)
  – Proportional share of the royalties
• Mandatory pooling (R.C. 1509.27)
• Unitization (R.C. 1509.28)
• Pugh clauses
  – Horizontal
  – Vertical
Oil and Gas Lease Terms

• Damages
  – Water testing
    • Existing water wells
    • Drinking water source
  – Indemnification/Hold Harmless

– Insurance
  • Commercial general liability insurance
  • Worker’s compensation insurance
  • Automobile/umbrella insurance
  • Environmental insurance
  • Landowner named as additional insured
Oil and Gas Lease Terms

• Facilities
  – Setbacks
    • Lease terms vs. Statutory minimums
  – Landowner approval of locations
  – Limitations on pipelines
    • Use in transporting oil/gas from Leased Premises
    • Depth and construction method
    • Separate ROW/easements (NEXT BIG ISSUE)
  – Limitations on roads
    • Size and maintenance
Oil and Gas Lease Terms

- Miscellaneous
  - Dispute resolution
    - Arbitration vs. Ohio courts
  - Warranty of title
  - Notice of drilling
  - Release of lease (Does it have teeth?)
  - Assignment
    - Notice
    - Landowner consent
Oil and Gas Lease Terms

• Miscellaneous continued
  – Memorandum of lease (?)
  – Subordination of Mortgage
  – Force majeure/shut-in limits
  – Audit
  – Property taxes
Statutory Forfeiture Process

• Ohio Revised Code 5301.332
  – Clearing up old leases vs. offensive tactic
  – What is HBP?
Drilling on publicly-owned lands

- The Ohio Revised Code authorizes the leasing of publicly-owned land
  - R.C. 307.11 (counties)
  - R.C. 505.11 (townships)
  - R.C. 3313.45 (schools)
  - R.C. 721.03 (municipalities)

- House Bill 133 (state)
  - Oil and Gas Leasing Commission
  - Public bidding process
  - Classification of state lands
Municipalities

• R.C. 721.03 (leasing of real property) vs. City Charter
  – **Requirements under R.C. 721.03**
    1. Property not needed for any municipal purpose
    2. The municipality passes an ordinance authorizing the lease. (RC 721.03).
    3. A public meeting is held. (RC 1509.61).
    4. The lease is approved by a two-thirds vote of the members of the legislative authority of such municipal corporation (e.g., city council). (RC 721.03).
    5. The lease is approved by the board or officer with supervision or management over the municipality’s real estate. (RC 721.03).
    6. The opportunity to lease is either advertised in a newspaper of general circulation in the municipal corporation at least once a week for five consecutive weeks or the requirements in RC 7.16 are followed. (RC 721.03).
    7. The lease is entered into with the highest bidder.
  – Municipality retains power to reject and rebid
Practical Considerations for Public Entities

- Drilling vs. non-drilling lease
  - Non-drilling or non-surface use lease preferred for school districts

- Public records
  - Recording of lease vs. lease memorandum

- Community relations
  - Public meetings, public opposition, education
House Bill 133

Legislative history

- March 1, 2011: Introduced in Ohio House of Representatives
- May 25, 2011: Passed by Ohio House (54-41)
- June 15, 2011: Passed with changes by Ohio Senate (22-10)
- June 21, 2011: Ohio House concurred with Ohio Senate’s changes (57-39)
- June 30, 2011: Governor John Kasich signed HB 133
- September 30, 2011: Effective date of HB 133
Oil and Gas Leasing Commission

- New state agency
  - 5 members
    - Chair = Chief of ODNR Division of Geological Survey (state geologist)
    - 4 others appointed by the Governor by end of October 2011?
      September 2012?

- Mission: oversee and coordinate the leasing of land owned or controlled by a state agency, university or college
  - 270 days to establish rules implementing HB 133
Classification of State Lands

• Inventory of state-owned lands
  – Responsibility of each “state agency”

• 4 different classes of property
  – Class 1: no encumbrances or deed restrictions
  – Class 2: land owned by state college/university or state agency subject to a federal encumbrance or monetary interest limiting oil and gas development
  – Class 3: Class 1 property that is not large enough to satisfy the minimum acreage requirements for drilling (cannot be leased, but can be included in a unitization agreement)
  – Class 4: land subject to an encumbrance or deed restriction

• ODNR will list all lands on its website with classification
Nomination of State Lands for Oil and Gas Leasing

• What is a nomination?
  – Proposal to make a certain parcel available for oil and gas leasing

• Who can make a nomination?
  – Not exactly clear, but at least includes oil and gas developers
  – Rules to be developed to provide details on the nomination process
Nomination of State Lands for Oil and Gas Leasing

- The nomination process
  - Written nomination (specifically identify parcel)
  - Oil and Gas Leasing Commission reviews (30-120 days)
    - Must approve/disapprove within 6 months
    - Notice to relevant state agency if approved (allowed to submit special leasing conditions)
  - Review of nominations
    - Statutory criteria
Bidding Process

• Bid package
  – To be determined as part of rule-making
  – Confidential bidding process
• Advertisements
  – Posted on ODNR’s website
• Bid Review
  – Highest and best bidder (gives the Commission discretion)
Royalties/Payments to State of Ohio

• State Land Royalty Fund
• Lands controlled by ODNR
  – Division of Forestry
  – Division of Wildlife
  – Division of Parks and Recreation
• State Parks
  – 30% of proceeds must be used to fund capital improvements at the park subject to the oil and gas lease
Landowner Groups

• What are they?
• Where are they?
• What are the benefits?
Benefits of Landowner Groups

• **Little, if any, up-front cost to landowners**
  – Landowners generally not responsible for costs (e.g. copying, travel, etc.)
  – Legal and consulting fees generally paid out of up-front bonus **ONLY AFTER** an oil and gas lease is signed

• **Group purchasing power**
  – Pooled resources
  – Maximize available information
  – Increase negotiating power
  – Obtain more landowner friendly oil and gas lease terms
Questions?

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