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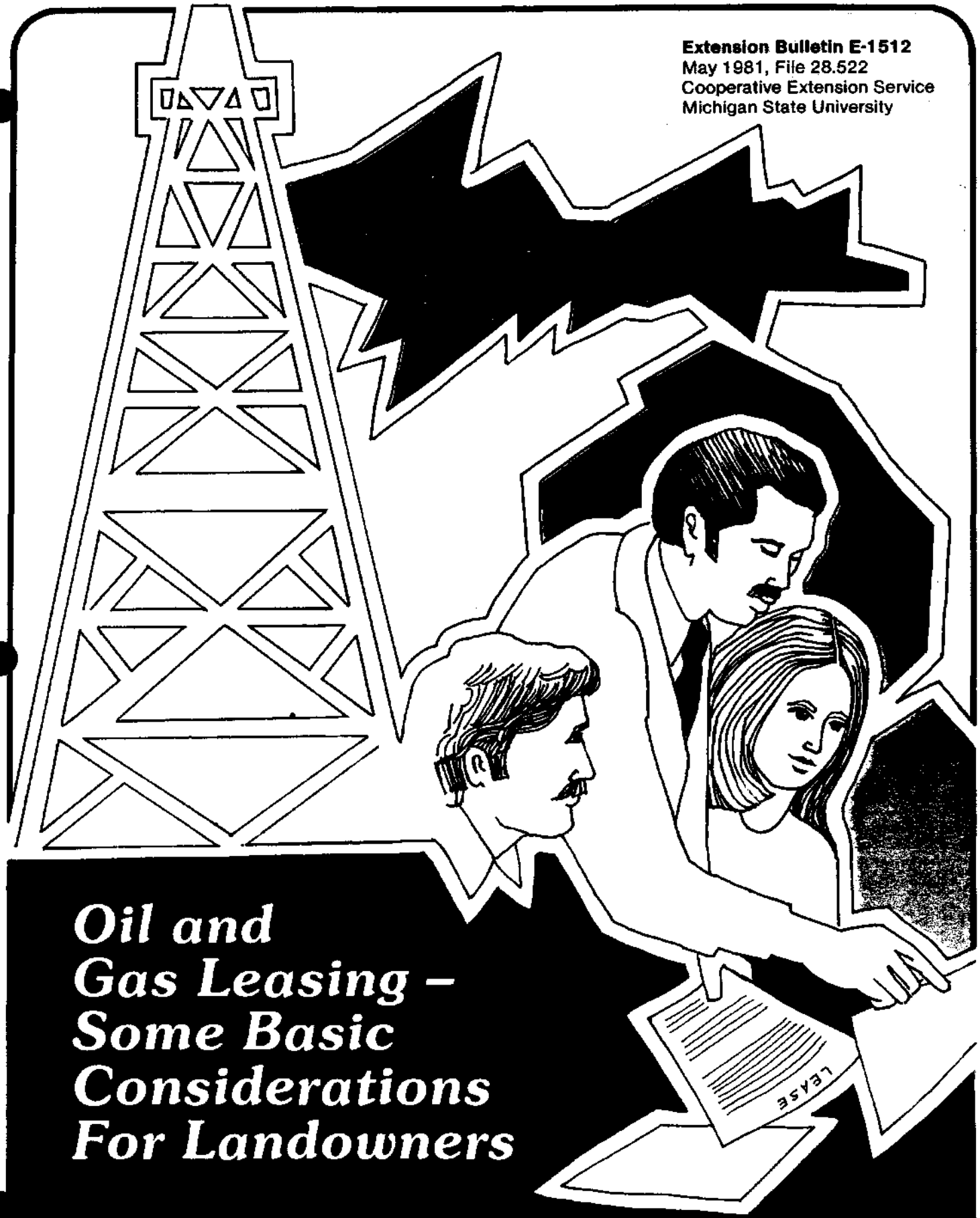

Oil and Gas Leasing – Some Basic Considerations For Landowners

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This Bulletin should answer many of the questions Michigan landowners have recently been asking regarding factors to consider before signing an oil and gas lease.

We start with a single premise: that landowners own their land and minerals[1] and, therefore, they have the right to negotiate an acceptable lease or refuse an offer. To negotiate effectively, and to decide if an offer is acceptable requires an awareness of the options often stated in the legal language of a lease.

The landowner generally has much less experience negotiating a lease than those interested in acquiring the lease rights. Our goal, therefore, is to familiarize the landowner with: (1) the primary trade-offs to be considered when leasing oil and gas rights, and (2) a number of additional, often equally important, considerations the landowner might want to discuss with the lessee.

Introduction

Many Michigan landowners are being approached by petroleum companies or their leasing agents who wish to lease property for oil and gas exploration. Landowners stand to gain financially from leasing these mineral rights. In some cases profits could be substantial, continuing for many years.

Unfortunately, negotiating a "good" lease is usually an unfamiliar process for the landowner. A good lease (1) guarantees the landowner a fair rate of return on production: (2) is set for a term long enough to allow the driller to thoroughly explore for oil and gas; and (3) accounts for inconveniences and disruptions related to development efforts.

Before signing a lease, it is important that landowners understand the rights and obligations proposed in the lease. They must recognize those statements on the printed form that are actually negotiable, and which of these "negotiables" are most significant to their particular needs. It is also important to know the type of demands that can make the conditions of a lease unacceptable to an oil company — not granting the company enough time to actually drill, for example.

There must be "give and take" by both parties to reach a mutually beneficial lease agreement. Hopefully, this publication will *help landowners* negotiate more equitable lease agreements and help insure that their "give" will not too far outweigh their "take" of the proceeds from their oil and gas rights. We have raised some basic questions and trade-offs to think about when first approached with leasing offers.

This publication is not intended to be the last word on oil and gas leasing. There are often unique circumstances related to the specific lands involved, the particular economic conditions, or the family responsibilities of the landowner. Remember, a lease is a legal document defining the rights and duties of both the landowner (the lessor) and the oil company (the lessee). Once it is signed, the lease cannot be changed by just one party. It is a temporary claim on the property recorded on the deed. Therefore, if there is any uncertainty about a specific clause in a lease, seek the advice of an attorney with experience in oil and gas leasing.[2]

Beware of the so-called "lease jockeys" — speculators operating on their own or under commission. Some of these speculators are not being completely honest with landowners. Reputable oil drilling companies, by contrast, would rarely allow their landmen or lease brokers to veil the truth to the landowner's disadvantage. They recognize the value of "goodwill" in working with a satisfied landowner after the lease has been signed and exploration begins. Fly-by-nighters, however, may present half-truths strictly for their advantage. Here are a few examples that have been related by Extension field staff:

Misconception #1: "This is a standard Michigan lease and therefore you should sign this one."

FACT: There are many so-called "standard" leases for oil and gas, but there is no official "Standard Michigan Lease". It does save time for a leasing company to have a standard form which covers the essential conditions for petroleum explora-

[1] In some cases in Michigan, the mineral rights have been "severed" from the surface rights. If a landowner is in doubt as to the ownership of minerals under his or her land, the deed should be checked.

[2] For most of us, the thought of contacting a lawyer sounds expensive, if not a little scary. But in the long run, and probably even the short run, good legal counsel will save both money and peace of mind. Rates *start* at about $40 per hour; often two or three hours are sufficient. For a list of lawyers belonging to the Michigan Oil and Gas Association, check their latest *Directory* in your library or call the Michigan State Bar (517) 372-9503 for the members of their standing committee on oil and gas. It's been said that most people learn a lot about oil and gas leasing the week *after* signing an agreement. Unfortunately, a lease is a binding document. A relatively small expenditure for legal counsel before signing is likely to repay itself many times over.

tion and development. However, an oil and gas lease is a private contract and therefore all conditions and terms specified in the lease are subject to negotiation and final agreement between you and the leasing company. The landowner has every right to question any part of the proposed lease, reject the entire lease, or negotiate for better terms.

Misconception #2: "If you refuse to allow oil and gas drilling on your land, you'll hold up any developments on your neighbors' land as well."

FACT: When an oil company cannot assemble the minimum block of land required for drilling (usually 40 or 80 acres) on account of a minority of the acreage owners "holding out", compulsory pooling may be ordered by the Department of Natural Resources (DNR). This forced pooling provision of the law protects leased owners from being denied the right to produce their minerals. Therefore, a compulsory, complete lease-unit, including the holdout, is formed from which oil and gas may be developed. Still, no actual drilling will occur on the non-leasing landowner's property.

Misconception #3: "If you are a non-leasing landowner forced to pool (as above), you may not receive economic compensation for your oil and gas."

FACT: If your land is within a production unit, you must receive some compensation for the oil or gas produced. Generally, with forced pooling the "hold-out" landowner is presented three options: (1) one last chance to accept the lease; if you still don't sign, then you can choose either of the following option, (2) before the well is drilled pay your proportionate share of actual drilling costs (based on the percent of land you own within the drilling unit) and thereby become a working partner in the well-venture, or (3) after a successful well has been drilled, you will be brought in as a working partner assessed a proportionate share of drilling costs plus a penalty payment that is meant to compensate the driller for accepting the risk-of-drilling what could have been an unsuccessful well. This penalty payment ranges from 100% to 300% of the proportion of drilling costs and is deducted from the initial production before any royalty payments are made to the landowner.

Misconception #4: "If you don't sign now, the oil company can drill on adjacent land and drain your oil without a lease."

FACT: This is a half-truth, but in practice, seldom materializes. First, if your land is next door to a new oil or gas discovery, and you have not leased, several oil companies will probably be very interested in negotiating a lease for your prime land. Secondly, the 40 or 80 acre production units established by DNR spacing orders are large enough to prevent drainage of adjacent lands for most of the geological formations in Michigan. By specifying in the lease that their company must drill to prevent draining, the landowner is protected against oil or gas being drained by an adjacent, but unshared well. If the landowner is unleased, but demonstrates to a judge that his/her land is being drained, the court will order compensation.

Many other misconceptions exist, and the wise landowner must be wary of new, "creative" pitches. Remember, you own the land and minerals and deserve the major voice in their development.

Some First Considerations in Oil and Gas Leasing

Lease or purchase? The first question to be clarified in considering a petroleum development proposal is whether the offer is for the leasing of oil and gas rights or for the outright purchase of mineral rights. In most cases, oil and gas rights are leased because producers do not need to own the surface land to extract the oil and gas resources. Exploration and drilling activities usually cause relatively minor, temporary surface disruptions. There will be some damage and disturbance caused by drilling, but this can usually be corrected with treatment and time; if not prevented altogether with the special precautions required by the DNR under the drilling permit. This differs of course, from the extraction of most other minerals (for example, coal or sand and gravel), which causes major alterations to the landscape. For these minerals, full purchase of mineral rights or buying the land outright might be more appropriate.

Compensation for any damages or lost surface value anticipated with oil and gas development should be specified in the lease. In some cases, an oil company may want to purchase outright a small portion of land for use in locating production equipment, storage tanks, buildings, etc., but such purchases are rare. It is important to realize that merely leasing the sub-surface minerals implicitly grants certain rights-of-access that can involve use of the land surface. Generally, an oil company must be allowed to come onto land it has leased to explore for and produce the buried oil and gas minerals it is leasing. The location of access roads and drilling sites should always be a matter of negotiation (discussed later in the "Other Considerations" section).

It is also possible to negotiate a "non-development" lease if the landowner has compelling reasons to prohibit use of surface lands. This might occur when subdivision lots are included in a 40 acre lease block, for example; or where the desired minerals lie in-part under a recreational lake. Landowners must realize, however, that even with today's sophisticated, directional drilling technology, being

denied access to the land surface may place such large restrictions upon the drillers that they will choose to look elsewhere.

Analyzing the Terms of an Oil and Gas Lease

The most important terms of an oil and gas lease can be placed in three major categories:

1. The bonus and/or rental payment to the landowner;
2. The royalty (landowner share) of any oil and/or gas produced;
3. The period of time (years) covered by the lease agreement.

Many other aspects of an oil and gas lease can also be significant, and will be discussed later in the section: "Other Considerations". People experienced in petroleum leasing tend to agree that the above factors should receive top attention in any agreement, because of their importance and also because tradeoffs between these often occur during negotiation.

From the landowner's standpoint, the best possible arrangement of these factors can be stated quite simply. The lessor should strive to negotiate the *highest bonus* payment possible with the *largest royalty* rate possible, covering the shortest time period practical. But what is "possible" and "practical"? The specifics vary from one region to another and according to different landowner preferences. Therefore, each of these major categories must be considered in more detail.

The bonus and/or rental payment: Petroleum companies interested in leasing property for exploration and possible development normally offer a one-time payment to the landowner for signing the lease. This bonus payment is a tremendous temptation to people who are in financial need or who prefer "money in hand". Bonus payments are very important, because if an oil or gas exploration effort proves unsuccessful, the bonus payment is the only benefit the landowner will receive for the lease.

The lessor (landowner) must be careful not to overemphasize the bonus payment at the expense of the royalty returns. For a producing well, royalties could easily be 10 to 20 times the bonus payment in the first year of production alone. Essentially, it boils down to balancing the "sure" bonus payment against the *chance* of a successful well and the high royalty returns a producing well can bring. The "average" chances of striking a "wildcat" well in Michigan range from 1-in-3 to 1-in-10 depending on the geologic region, the drilling company, and a number of other variables. Fortunately, the question of bonus *vs* royalty is usually not an all-or-nothing trade-off in a lease. It's more a matter of how much bonus a landowner might give up to get a slightly higher royalty rate, or vice versa.

Generally, in areas where there is competition between companies to acquire leases, a $25 per acre bonus is currently (1981) considered about the minimum for a "serious" offer.[3] The word "generally" should be emphasized here because there is no rule or average. Some recent bonuses in "hot" prospect areas have been in the $250 to $300/acre range and more, although these are the exception. In areas with lower geologic potential or where landowners stressed other lease factors, the bonuses naturally tend to be less, ranging from $25/acre to as little as $1/acre. The landowner must recognize the gamble of holding out for too high a bonus (as with any other factor of the lease), causing a prospective lessee to pass up the property and look elsewhere.

The royalty percentage. Royalty rates are of special importance to a landowner contemplating a lease offer, as the potential value of a producing (i.e., royalty-yielding) well overshadows other considerations. While a bonus offer of $50/acre, $100/acre, or even $1,000/acre may sound impressive, these figures pale when compared with an active well producing 200 barrels of oil per day (at $40/bbl) for 200 production days out of the year (realistic figures for Michigan). Such a well would gross $1.6 million in a single year alone.

The landowner's minimum share (i.e., a 1/8 royalty) of this "average" Michigan well would be $200,000 per year. Therefore, if the landowner leased the full 80 acre drilling unit for say $100/acre, the total $8,000 bonus "bird-in-hand" must be weighed against what might be a 20 % *chance* of receiving the $200,000/year royalty. Based on these odds, royalty rates become very important. (Some of these variable bonus and royalty rates for the "average" Michigan well are presented in Table 1 to help landowners consider the trade-offs).

Most of the so-called "standard" oil and gas leases offer the landowner a ⅛ royalty share. A royalty of 3/16 is generally considered the maximum. However, royalty payments can be any percentage that the landowner is able to negotiate, and he or she should not accept arguments that oil companies will refuse royalty percentages higher than ⅛.[4] The fact is, royalty payments of up to 25 percent or more have been negotiated where there was an especially high probability that the land being leased contained an oil or gas deposit. Needless to say, such royalties can only be expected with an exceptional site. Demanding too much can drive the oil companies away. The landowner must balance his or her demands with realistic expectations for production.

[3] Inflation will change any price figure mentioned, so it may be helpful to think of this $25/acre as a proportion of the land's value in 1981: or approximately 2.5% of the property value.

It is important however, that the landowner try to obtain a royalty rate as high as possible because even a small incremental increase in the rate can greatly increase revenues if the well is successful. For example, if a lease arrangement providing a 3/16 royalty share can be negotiated, instead of the "standard" ⅛ (2/16), royalty payments would be exactly 50 % higher, or $300,000/year for the example discussed above. Note that this is an *increase* of $100,000/year. (See Table 1.)

[4] The State of Michigan has recently revised its state land oil and gas leasing terms so that it will now receive a 1/6 royalty.

TABLE 1. BONUS vs. ROYALTY

Given:
- **80 acre lease[1]**
- **20% chance of wildcat success[2]**
- **"Average" Michigan wildcat production:**
  200 barrels/day[3]
  200 days/year[4]
  $40/barrel[5]
  ***Therefore*, $1,600,000/year - total well value**

BONUS:

@ $1/acre	=	$80
@ $25/acre	=	$2,000
@ $100/acre	=	$8,000
@ $300/acre	=	$24,000

Trade-offs

$6,000; (known, now, one-time)

ROYALTY:

@ 1/8	= 12.50%	=	$200,000/yr.
@ 5/32	= 15.63%	=	$250,080/yr.
@ 1/6	= 16.67%	=	$266,666/yr.
@ 3/16	= 18.75%	=	$300,000/yr.
@ 1/5	= 20.00%	=	$320,000/yr.

$100,000/yr.; But only 20% chance of receiving it (risk, delay, continued over production life)

Footnotes to Table 1

1. Well spacing in Michigan is regulated by the Department of Natural Resources (PA-61:1939) to minimize waste of oil and gas during production and to ensure equitable distribution of these natural resources to their proper owners. The "normal" drilling unit for each well is a 40 acre government-surveyed, quarter-quarter section of land. Exceptions to the 40 acre rule are made in order to maximize the ultimate recovery of oil or gas from a particular field or to reduce surface damage. Therefore, some drilling units are smaller (10 or 20 acres) and some are larger (80, 160 etc.). These variations from the 40 acre norm are made on the basis of spacing orders issued by the Supervisor of Wells. We have used 80 acres because of the spacing orders established for the north and south Salina-Niagara trends.

2. The success of "wildcat" wells (officially designated as "exploration" wells) for all of Michigan in 1979 was between 25 and 30%. Much of this drilling was in the Salina-Niagara reef zones which were more predictable than the areas currently being drilled. (See Michigan Geologic Survey Division, DNR, *Michigan's Oil and Gas Fields, Annual Statistical Summary 1979*, Lansing: October 1980, p. 5.) Wildcat successes in the deeper, less understood strata which is presently being drilled is going to be lower, and thus a more conservative 20% success-ratio is used in the examples calculated.

Wildcat (or exploratory) wells are distinguished from "developmental" wells in that wildcats are located further away from existing, producing wells. Developmental wells are generally within 2 miles of a producing well; wildcats are drilled more than 2 miles away from existing, successful wells.

3. Daily production from a well varies greatly from one pool to another and over time. Most of the current wells in Michigan have very low daily production; in fact, some 4,000 of the more than 7,000 producing wells are producing less than 10 barrels of oil per day. These are called "stripper" wells. It is interesting that Michigan's situation does not differ much from the nation as a whole where more than 40% of all domestic oil production comes from stripper wells.

Most of the wells in the Salina-Niagara region, however, are more productive. In the north, many of these wells are pro-rated at 300 bbl/d (or 450 Mcf of natural gas); in the south, they have been typically regulated at 200 bbl/d (or 200 Mcf). These are their maximum allowable productions. Thus, to assume a 200 bbl/d production is reasonable.

4. Pumps and other producing equipment need repair and maintenance. Paraffin, for example, frequently clogs wells and production must stop while the waxy material is removed. As a result, "normal" production is usually sustained for only 200 to 225 days per year. We use 200 days here to be on the cautious side.

5. March, 1981, prices for Michigan oil at the well-head were $36/bbl for "sour" oil and $38/bbl for "sweet" according to Wyanot Pipeline Co., Mt. Pleasant, Michigan, (517) 773-9978. With the continued rise in prices expected, we have used $40/bbl in our example to account for the delay between the signing of a lease and the time when a well might eventually start producing.

Time period covered by the lease. Generally speaking, it is to the landowner's advantage to negotiate a short lease. The sooner the lease can be completed, the sooner the lessor (landowner) has the commitment on his or her property removed. If no serious exploration has occurred, the landowner may have the option to lease the same mineral rights to other companies, possibly under more profitable arrangements. But, at the same time, if the landowner expects to accrue the full benefits of the lease, he or she must allow the lessee (petroleum company) a reasonable time period for exploration and well drilling. As a general rule, landowners should seldom consider leasing for oil or gas exploration for more than a five-year period. Oil companies may argue that they need longer to obtain leases on enough land to explore and determine if drilling efforts are justified. But in most cases, a

company that cannot develop an area within five years is probably not very serious about exploring and drilling.

Typically, landowners should receive a higher bonus and/or royalty share as the length of a lease is increased. If the lease is highly favorable in terms of royalty and bonus payments, the landowner can afford to allow a longer lease period for exploration.

If oil is discovered on the leased property, it is to the landowner's advantage to have a clause in the lease specifying that the company will drill on remaining lands under the lease or relinquish them at the end of the primary term of the lease. If production is occurring on adjacent property, the landowner would benefit from a clause in the lease stipulating that his lessee must also drill to prevent drainage of oil or gas from beneath his property.

Serious leasing vs. speculative leasing. Before considering other factors in oil and gas leasing agreements, we offer another word of caution. When lease offers are made with very small bonus payments, no serious negotiation on the royalty payment, and the prospective leasing company is attempting to obtain a long-term lease that includes all minerals (instead of just oil and gas), it is very likely that the lease is speculative (unless the area is far removed from any other exploration or production activity). A company that is "speculating" in mineral rights will be leasing with the hope of subleasing mineral rights to whatever companies become interested in actually doing the exploration for oil, gas, or other minerals. A "middle-man" like this usually makes money at what turns out to be the landowner's loss. Landowners are generally better off if the company they lease to is actually a drilling company and thus capable of exploring for their minerals.

As lessors, landowners always risk finding out later that the lease they agreed upon could have been sold for more money or a higher royalty. Those who don't lease, however may lose the opportunity to lease their oil and gas rights altogether, especially if their property is located in marginal petroleum areas. For some, serious financial needs may dictate immediate leasing, even for very small returns. For others, if only a small payment per acre is at stake, it may be wise to hold onto all mineral rights and hope for better technological and market conditions that could yield more in the future.

The landowner can never avoid all risk in accepting or rejecting a lease. Like the ultimate exploration for the oil and gas itself, there is always some gamble in leasing. In any case, if a lease offer appears speculative in character, the prudent landowner will show special restraint. Try to negotiate the best lease possible under the circumstances rather than accepting what is immediately available.

Other Oil and Gas Leasing Considerations

In addition to the three leasing considerations discussed, many other concerns deserve careful attention. Some of these can be very important in certain instances. Here are several items to seriously consider *after* the first three items (bonus, royalty, and length of lease) have been settled, but *before* signing a lease:

1. Although state statutes (Public Act 61 of 1939 as amended and PA-197 of 1959) cover surface damage and cleanup regulations for petroleum developments, landowners may specify other requirements beyond the statutory language. If there is doubt as to how a particular damage would be covered, the lease should specify amounts and procedures for reimbursement. Areas of damage that should be considered are fences, trees, crops, livestock, etc. Potential problems associated with access to the land might also be covered by the lease.

2. An oil and gas lease should also specify any areas where drilling is not to be allowed. The landowner should specify any restrictions that may be placed on drilling within a certain distance of residences, farm buildings, ponds or other areas of significant value. Remember, there is noise and movement of people and equipment around a drilling "rig," and a producing oil or gas well may emit offensive odors.

3. The lease should specify any conditions which will terminate the lease. One approach is to pick out the sections of the lease which are most critical to the landowner and specify that any violation of those conditions by the petroleum company will be considered a default and therefore terminate the lease. Failure to make payments, for example, might be one cause for termination.

4. The lease should also limit an oil company's right to shut-in (or "cap") a successful well. Many gas wells are shut-in until they can be connected to pipelines, certainly a justifiable delay. Leases may specify, however, that an operator use "due diligence" to bring a well into production.

5. Consider conditions which may extend a lease when drilling is not completed (or even started in some cases) by the time the lease is to expire. Most leases will specify that if a well is "in the process" of being drilled, the lease is either automatically extended or can be extended with nominal payments (such as one dollar per acre). The landowner should make sure that the definition of "drilling in progress" is clearly specified. Some landowners have found that just prior to the termination of a lease, a company may stake and bulldoze an area and claim that well development is in progress. A protection against this ploy may be to re-

quire "due diligence" to continue drilling once it has been started or to define a well in progress by specifying that drilling must have reached some minimum depth (such as 200 feet). Also, an additional bonus payment equal to the original may be required for extensions of the lease where drilling is not completed at the time the lease is to expire.

6. The lease should stipulate what procedure will be followed in case judgments have to be made concerning property damage or other considerations where accurate measurement of damage may not be possible. In most cases, the deliberation of an arbitration committee is considered the appropriate procedure for estimates or judgments in determining the magnitude of damages involved. The lease can specify who should participate on such a committee.

7. Terms for oil and gas storage (either underground or surface) have often been included as part of exploratory and drilling lease agreements. It is to the landowner's advantage, however, to stipulate such terms on a separate lease. Not only are the rentals for storage lucrative, but it is also a future matter and thus the value of storage rights is likely to increase.

8. An oil or gas lease should specify the conditions for payment of royalties and any penalties for failure to pay.

9. A landowner may want to specify in the lease that free copies of company exploration records will be furnished for tests conducted on the leased property.

10. The landowner may also want to require that any reassignment of a lease to a third party may only occur with the express knowledge and/or permission of the landowner. To require the landowner's permission for reassignment may discourage speculators who want to lease the oil and gas rights (and maybe other minerals), but do not intend to develop them.

11. The landowner with a large tract of land may want separate leases for each block. The normal production unit, as regulated by the Michigan DNR, is a 40 acre block comprising one-quarter of a quarter-section in the regular government survey system.[5] Thus, the landowner may want to lease blocks of land separately so as not to tie up more land than necessary when one test well is begun.

12. Some companies want large tracts of land for drilling to protect their investment. Several owners may be asked to join a pool and share, in proportion to their land in the pool, any oil or gas produced. Pooling arrangements should be completed prior to drilling, if possible, *and* any properties not voluntarily in the pool should be on a separate lease so that they won't be affected by pool decisions.

The above items are listed as examples of "other considerations" which may be specified in a lease. For the most part, these have been addressed in terms of protecting the landowner's interest. The list is not all-inclusive, but provides key examples of the type of specifications a landowner may wish to negotiate in an oil and gas lease. Note that state and federal rules and laws take precedence over any and all terms of a lease. See Geological Survey Division, Michigan DNR, "Michigan's Oil and Gas Regulations", Circular 15 (Lansing, DNR, Box 30028, 48909): 49 pages, Jan. 1, 1981 — (517) 373-1256. The lessee and lessor are subject to all existing laws, and both parties may have certain rights or obligations not expressly stated in their written agreement.

Michigan Oil and Gas "Boom"

A combination of new technology, national and international energy policies, availability of capital, and the high well-head price of oil and gas are all stimulating Michigan exploration. Unless the current drilling unveils some very unexpected geologic "disappointments", the hunt for oil and gas in Michigan will continue at a brisk pace for many years to come. Michigan will never be "another Texas" (Michigan only produces about 3% as much petroleum as is recovered in Texas), but Michigan is still the 11th largest oil and gas producing state in the nation. Also, Michigan is one of the few states where oil and gas discoveries in 1980 exceeded production so that "proven reserves" actually increased.

A brief review of the broad oil and gas picture, as it currently influences exploration in Michigan, may enlighten and may affect the urgency that some feel toward negotiating their leases.

As we all know, the *price of oil and gas* has increased dramatically. Before the oil embargo of October 1973 the wholesale price of a barrel of crude oil was about $2.70 at the wellhead. Likewise, gas was selling for about 60¢ per thousand cubic feet. In March 1981, the price for a barrel of Michigan's "sweet" crude oil was $38 and gas sold for more than $2.50 per thousand cubic feet.

Another major incentive is government deregulation of oil prices, which has increased the prospects for domestic oil and gas development. The industry now has more flexibility in setting prices. Deregulation increases the profit potential for oil and gas development.

A third incentive is the *recent successes* in Michi-

[5] For conservation reasons, the DNR has made exceptions to this rule on a regional basis so that there are some 10, 20, 80, 160, and 640 acres drilling units in the state.

gan including a major deep gas discovery in Missaukee County in the Winter of 1980-81.

The increased profit potential for oil and gas exploration has also provided incentive for development of new technology for locating oil and gas deposits. Drilling test wells is a very expensive process. But improved seismographic exploration, advances in deep well drilling, and the increased skills of geologists in the interpretation of underground formations, have all improved the chances of discovering oil and gas in formations previously considered to have low potential for development.

Some other factors influencing Michigan's recent exploration boom include Canada's new energy policy to nationalize a greater portion of its oil companies. This policy has caused many drilling rigs to leave Canada in the last few months and come to the U.S. Also, when natural gas prices are fully deregulated over the next few years, estimates suggest that natural gas will increase from 100 to 300% in value, thus stimulating further exploration.

Severed Mineral Rights

Another point that can be a major concern to a few landowners is how they might regain severed mineral rights. The Michigan Supreme Court recently (23 Dec. 1980) decided to *uphold* the "Dormant Mineral Act" (PA-42 of 1963) which causes severed mineral rights to revert back to the surface landowner if the mineral rights have not been formally exercised over the past 20 years. The intent of the Dormant Mineral Act is to encourage exploration and development of oil and natural gas in Michigan by reducing the difficulty of locating the rightful mineral owners.

Over time, *severed* mineral rights can become divided among many absentee owners, some of whom may not even realize their ownership rights and obligations, and who may be very difficult to locate. The Dormant Mineral Act *presumes abandonment* of the severed mineral rights and transfers them to the surface owner if the severed-mineral-rights owner has not, within the last 20 years:

1. developed the minerals (i.e., exercised the rights),
2. filed a continuing interest claim, or
3. transferred the interest to someone else by recorded instrument on the Deed.

The Michigan Supreme Court's recent determination that the Dormant Mineral Act was *not* unconstitutional means that *it is legal* and in the public interest to terminate the ownership interest of inaccessible owners (ones who cannot be found by reasonable diligence) and vest that ownership in the surface owner. This case was "VanSlooten *vs.* Larsen", decided December 23, 1980. An appeal is now before the U.S. Supreme Court.

Summary

To summarize, here are some "common sense" suggestions about leasing:

1. Don't sign anything you don't understand.
2. Ask your neighbors what rates they received.
3. Most companies use the bonus to compete for leases. But, if oil or gas is discovered, the royalty rate specified in the lease will be more important in determining how much money the lease produces for you.
4. The length of lease is another negotiable item. Ten years used to be standard; Michigan has agreed to 7 (with a one year extension possible) on state-owned land. In active areas, 3 to 5 years is now more common.
5. Remember to negotiate all those "other" factors (like where access roads should go and what might terminate the lease) *before* you sign.
6. You may feel better if you know that the company you are negotiating with actually has the capacity to drill. Resale of leases may delay exploration.
7. Get all verbal promises or commitments in writing and signed.
8. Check with an experienced oil and gas attorney.

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