

A green-tinted photograph of an oil pumpjack in a desert landscape. The pumpjack is the central focus, with its long walking beam and counterweight visible. The background shows a flat, arid plain under a clear sky.

AN INTRODUCTION TO THE LEASING OF STATE LANDS FOR OIL & GAS

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ATTORNEYS

STATES

- Alaska
- Colorado
- Montana
- New Mexico
- North Dakota
- Oklahoma
- Texas
- Utah
- Wyoming

TOPICS

- Overview of Common Terms
- Background
- Issuance
 - Leasing Process & Procedure
 - Rentals and Royalties
- Perpetuating the lease
- Assignments
- Pooling State Interests

The image features two large, thick black L-shaped brackets. One is positioned in the top-left corner, and the other is in the bottom-right corner, framing the central text. The text is centered between these brackets.

OVERVIEW OF COMMON TERMS

- **Oil and Gas Lease:** The instrument, or contract, by which a leasehold or working interest is created
- **Working Interest:** Right to explore for, develop and produce the minerals. Includes the right to profits and the obligation to pay costs. Working interest owner known as the “**lessee.**”
- **Types of Royalty Interests**
 - **Landowner’s Royalty:** mineral interest owner’s compensation under the lease. This is the royalty paid to the state.
 - **Overriding Royalty:** royalty interest carved out of a lessee’s leasehold working interest.

- **Primary Term:** The period of time during which a lease may be kept alive by a lessee even though there is no production in paying quantities by virtue of drilling operations on the leased land or the payment of rentals.
- **Secondary Term:** The period of time during which a lease has been extended by production in paying quantities or some savings clause in the lease.
- **Delay Rentals:** A sum of money payable to the state by the lessee for the privilege of deferring the commencement of drilling operations or the commencement of production during the primary term of the lease.

- **Deductions:** Certain items can be deducted from the royalty paid to the state.
- **Processing costs:** Any process designed to remove elements or compounds from gas, including absorption, adsorption, or refrigeration.
- **Transportation costs:** The costs of transporting oil or gas to a market.
- **Gathering Costs:** Costs of transporting the oil or gas from the leased lands to the main pipeline in the area.
- **Marketable Condition:** Oil or gas sufficiently free from impurities that it will be taken by a purchaser. (standard definition) (states may differ)

- **Pooling:** The voluntary bringing together of small tracts sufficient for granting of a well permit under applicable spacing rules.
 - **Forced Pooling:** Involuntary; required by law, order, or regulation
- **Unitization:** The joint operation of all or some portion of a producing reservoir.

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BACKGROUND

Alaska

- 105 million mineral acres of state land
- Alaska is required to reserve all minerals when disposing of interests in state lands
- Managed by the Alaska Division of Natural Resources
- Unique dynamic between State and Native regional corporations

Colorado

- Approximately 4 million mineral acres of state land
- Managed by Colorado State Land Board
- Oil & Gas leasing overseen by Oil & Gas Specialist

Montana

- 6.2 million mineral acres of state land
- Managed by the Trust Lands Management Division of the DNRC
 - Under the direction of the Board of Land Commissioners
- Oil & Gas leasing by the Minerals Management Bureau

New Mexico

- 13 million mineral acres of state land
- Managed by New Mexico State Land Office
- Oil & Gas leasing overseen by Oil & Gas Division Deputy Director

North Dakota

- 2.6 million mineral acres of state land
- Managed by Board of University & School Lands
- Oil & Gas leasing by the Director of Minerals Management

Oklahoma

- 1.1 million mineral acres of state land
- Managed by Minerals Management Division of the Commissioners Land Office

Texas

- Texas owns oil and gas rights in 18.8 million mineral acres
- Multiple types of State Lands
 - Public School Fund – 7.3 Million acres
 - Permanent University Fund – 2.1 Million acres
 - Mineral-Classified Relinquishment Act Lands – 6.3 Million acres
 - Free Royalty Lands – 822,895 acres
- Administration
 - General Land Office (“GLO”) manages the leasing of PSF lands
 - School Land Board runs the GLO and handles the administration of leases for most state agencies
 - Office of University Lands responsible for leases pertaining to Permanent University Fund Lands

Utah

- 3.4 million mineral acres of trust land.
- Managed by School and Institutional Trust Lands Administration
- Oil & Gas leasing managed by the Oil & Gas Group

Wyoming

- 3.9 million mineral acres of state land
- Managed by Board of Land Commissioners
- Oil & Gas leasing overseen by the Office of State Lands and Investments



ISSUANCE

Leasing Process In General

- Nominate a Tract
- Submit a bid
- Highest Bidder awarded the lease



Alaska

- Lease sales for specific areas are held once a year
- Best interest finding required for unleased land
- Competitive sealed bidding process
- Type of lease form depends on area
- “Middle Earth” – exploration licensing process

Colorado

- Quarterly auctions (Feb., May, Aug. and Nov.)
- Nominate tracts by filling out form on agency's website and submitting \$50 fee
- Lease offering process is handled via EnergyNet
- Online auctions are open for one week

Montana

- Quarterly sales (Mar., Jun., Sep., and Dec.)
- Nominate by submitting lease application form
- Live auction conducted by Bureau Chief
- If no oral bids received, the lease goes to nominee for \$1.50 per acre (\$100 min. if small tract)

New Mexico

- Monthly Sales
- Nominate tracts through email
- Lease offering process is handled via EnergyNet
- Hybrid Sealed-bid and live auction process

North Dakota

- Quarterly sales (Feb., May, Aug., Nov)
- Nominate by submitting nomination form and \$10
- Live auction conducted via EnergyNet
- Auctions open for one week

Oklahoma

- Nominate tracts by phone or email
- For auction, Oklahoma uses its own website:
clo.ok.gov/services/auction-information/minerals/
 - Can submit a written or electronic bid
- Leases are offered up for sale 6 times per year: January, March, May, July, September, and November

Texas

■ Public School Lands

- Leased via quarterly sales
- Nominations submitted in writing with \$100 fee
- Notice of sale published in 3 of 4 daily newspapers at least 30 days before sale
- Competitive bidding process (bonus vs. royalty bids)

■ Riverbeds and Channels

- Leased via quarterly sales
- Nominations submitted in writing with \$100 fee
- Competitive bidding process

Texas

■ Relinquishment Act Lands

- Owner of surface acts as state leasing agent
- GLO lease form required
- Bonus, delay rental and royalty terms negotiated by surface owner

■ University of Texas Lands

- Competitive, sealed bid process
- Advertised in newspapers and through mailing lists
- Different lease forms

Texas

■ Highway Lands

- Preferential right to lease given to mineral owner of adjoining acreage under most favorable terms of adjoining lease
- If no adjoining lease, State Land Board sets royalty, bonus and rental

Utah

- Quarterly auctions (Jan., April, July and Oct.)
- Nominating Tracts done via email or phone
- Lease offering process is handled via EnergyNet

Wyoming

- 3 sales in 2019 (Mar., July, and Nov.)
- Nominate through online nomination form
- Auctions are live via EnergyNet
- Online auctions are open for one week
- Over-the-Counter: if no bids are received for three consecutive sales



RENTALS &
ROYALTIES

Alaska

Rentals

- Entirety of the lease
 - Existing Leases
 - \$1.00/ acre for the first year
 - \$1.50/ acre for the second year
 - \$2.00/ acre for the third year
 - \$2.50/ acre for the fourth year
 - \$3.00/ acre for the fifth year and beyond
 - Most recent lease form
 - \$10.00/ acre per year for the first 6 years
 - Retains the right to increase the annual rental rate if lease is extended beyond primary term

Alaska

Royalty

- Royalty Rate: 12.5% - 16.66667%
- Royalty taken in value or in kind

Colorado

- Rentals: \$2.50/ acre during the entirety of the lease
- Royalty: 20% of the gross sales value of the oil and/or gas produced
- Deductions
 - Oil: Transportation deductions allowed after oil is in marketable condition
 - Gas: No deductions before gas reaches the first true commercial market

Montana

- Rentals - \$1.50 per acre (entirety of the lease); increase beginning 6th year.
- Royalty – 16.67% free of all costs and deductions
- No deductions

New Mexico

- Rental: Ranges from \$.25 and \$2 per acre throughout the life of the lease
- Royalties: depends on area
 - “Restricted” area– 1/8th
 - “Unrestricted” area – 1/6th, 3/16ths or 1/5th
- Deductions
 - Transportation
 - Gas Marketing Preparation
 - Gas Processing

North Dakota

■ Delay Rentals

- Not less than \$1.00/ acre during primary term

■ Royalty

- 3/16 or 1/6 depending on the county
- Oil – greater of (1) highest price posted for field; (2) highest market price paid for area; or (3) the gross proceeds of sale
- Gas – Calculated on the gross proceeds from the sale

Oklahoma

- Delay Rentals: \$1.00 / acre when the lease is issued
- Royalty: 3/16 for oil and gas
 - 1/5 for oil and gas on lands owned by the Oklahoma Department of Wildlife Conservation
- Deductions
 - Gas Processing

Texas

■ Delay Rentals:

- Public School Funds Lands: Negotiated by School Land Board
- Relinquishment Act Lands: At least \$0.20/ acre
- University of Texas Lands: Prepaid Delay Rental

■ Royalty:

- Public School Fund Lands: 20% to 25% for oil and gas
- Relinquishment Act Lands: at least 1/8 for oil and gas
- University of Texas Lands 20% to 25% for oil and gas

Utah

- Rentals - \$2.00/ acre, minimum of \$500 annually
- Royalty: 16.66667% of gross proceeds received
- Deductions –
 - Oil: transportation deductions only
 - Gas: processing and transportation

Wyoming

- Delay Rentals - \$1.00 per acre
- Royalty – 1/6th of market value (arm's length)
- Deductions
 - Oil: reasonable, actual, unreimbursed costs for transportation beyond storage tanks
 - Gas: reasonable, actual, unreimbursed costs for transportation in the market pipeline

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PERPETUATING
THE LEASE

How does the lessee maintain the lease beyond the primary term?



Production in Paying Quantities

- Production in such quantity as to enable the operator to realize a profit. I.e. production sufficient to yield a return in excess of drilling, development and operating costs

Shut-in Clause

- A lease clause which authorizes a lessee to pay a shut-in royalty and thereby keep a lease alive without actual production when and if a well has been drilled which is capable of producing gas in paying quantities but which is shut-in, usually by reason of lack of market

Shut-in Clause

■ Example:

If Lessee completes a well **capable of production** of Oil or Gas but Lessee is unable to produce such Oil or Gas due to a mechanical condition beyond Lessee's reasonable control, or the lack of suitable market, Lessor shall grant Lessee a suspension of its production obligation until a suitable market for such Oil or Gas is established or the mechanical condition is remedied, provided further that Lessee pay _____ dollars (\$_____) per acre of the Leased Land per annum, but not less than \$_____ annually (the "Shut-in Royalty Payment"). Lessee may extend the lease in one year increments for two additional successive years by paying the same amount prior to each anniversary date. Lessee may request additional one year extensions beyond the two successive years.

Drilling Operations Clause

- A lease clause providing that a lease may be kept alive after the expiration of the primary term and without production by drilling operations of the type specified in the clause continuously pursued
- Many western states require authorization before drilling beyond the primary term

Drilling Operations Clause

- Example:

If at the expiration of the primary term, oil or gas is not being produced but lessee is then engaged in bona fide drilling or reworking operations thereon, this lease shall remain in full force and effect so long as such operations are diligently prosecuted and, if they result in the production of oil or gas. Provided, however, such operations extending beyond the primary term shall be approved by the state upon written application filed with the state on or before the expiration of said term.

Cessation of Production Clause

- A lease clause providing that under certain circumstances a lease may be preserved despite cessation of production in the secondary term

- Example:

Should production cease from any cause after the expiration of the primary term hereof, this lease shall not terminate if lessee commences additional drilling or reworking operations within sixty (60) days after the cessation, and shall remain in full force and effect so long as such operations are prosecuted in good faith with no cessation of more than twenty (20) consecutive days, and result in the production of oil or gas in paying quantities; provided, however, written notice of intention to commence such operations shall be filed with the state within thirty (30) days after the cessation.

Alaska

- When the Primary term < 10 years: Lessee can request one-time extension of primary term, not to exceed 10 total years
- Production in paying quantities
- Committing the lease to a state-approved unit agreement
- Continuous Operations: Commencing Drilling by the end of the primary term and continuing drilling w/ reasonable diligence
- Temporary Cessation: Commencing reworking operations within six months if well is no longer producing in paying quantities

Colorado

- One-year Extension Term
- Production in paying quantities
- Shut-in provision

Montana

- Board of Land Commissioners have discretion to grant a reasonable extension of the primary term
- Production in paying quantities
- Continuous Operations: Commencing Drilling by the end of the primary term and continuing drilling w/ reasonable diligence
- Shut-in provision for gas
- Shut-in for oil

New Mexico

- Drilling or reworking operations at the end of the primary term
- Production In paying quantities
- Shut-in provision for gas
- Cessation clause

North Dakota

- Production in commercial quantities
- Temporary cessation clause
- Operations at the end of the primary term
- Shut-in provision for gas
- Shut-in policy for oil

Oklahoma

- Production in paying quantities
- Operations at the end of the primary term
- Shut-in provision for gas

Texas

- All state land leases in Texas are extended by production in paying quantities
- Public School Fund Lands
 - Extended by paying a fee to extend the lease rather than drilling past the primary term
- Relinquishment Act Lands:
 - Conducting drilling operations at the end of the primary term
 - Temporary Cessation Clause
 - Dry Hole Clause
 - Shut-in provision for oil and gas
- University Lands
 - Continuous Drilling Operations

Utah

- Cessation of Production
- Production in paying quantities
- Shut-in provision for gas
- Elimination from a federal unit – Two year extension
- Director discretion to grant extension of primary term

Wyoming

- Production in paying quantities
- Discretion of the Board
- Suspension of Operations for lack of market (Shut-in provision)
- Drilling operations prior to the end of the primary term



ASSIGNMENTS



Types of Assignments

- Working Interest Assignment
 - Partial
 - Undivided
- Operating Interest Assignment
- Overriding Royalty Assignment

Alaska

- Working Interest and Overriding Royalty Interest Assignments must be approved by the Division of Natural Resources.
- Financial Assurance requirements for the assignor

Colorado

- Oil and gas assignment form
- Must be approved by the State Land Board
- State will not acknowledge assignments of undivided interests
- Can assign an overriding royalty interest

Montana

- Assignment Form DS-424
- Assignment must be approved by the board
- Can assign undivided interests in the lease, but must list a designated agent

New Mexico

- State will not recognize assignments of an undivided working interest in the lease
- Must file a “Miscellaneous Instrument” for assignments of operating rights or overriding royalty interests
- Use State Land Office’s assignment form 0-30
- Cannot file “blanket assignments”
- Partial assignment segregates the lease

North Dakota

- Assignment form available at land.nd.gov
- Assignment must be approved by the Commissioner of University of School Lands

Oklahoma

- Must obtain written consent of the Commissioners of the Land Office
 - Do not need written consent to assign overriding royalty interest
- Materials required to assign
 - Bond of assignee or proof of Performance Fee
 - Copy of Assignment
 - Accompanying agreement (i.e. P&S agreement)

Texas

- Public School Fund Leases and RAL Leases
 - Provide proof of assignee's financial responsibility
 - Assignee only assumes liability under lease after GLO written approval
 - Must file the assignment in the county and with the GLO
- University Land Leases
 - Do not need approval from Land Board
 - Assignor remains liable to the state

Utah

- Assignment must be approved by the Director
 - Operating rights or working interest rights
- Must file Assignment of Overriding Royalty Interest with the State
- Requirements for assignment
 - Properly Executed
 - Identify the land and lease
 - Name and address of assignee
 - Interest assigned
 - Certification of Net Revenue Interest

Wyoming

- Assignment form must be used, available at OSLI's website
- Assignment must be approved by OSLI
- Assignee must be a “qualified lessee”



POOLING AND
UNITIZATION



Alaska

- Pooling: Forced pooling is authorized, but rarely used
- Unitization: the lease expressly authorizes the lessee to unitize the lease with other leases for the exploration, development, or operation of a pool or field, subject to state approval
 - Lease is severed when only a portion of the lease is committed to the Unit
 - Unitization automatically extends the lease

Colorado

- Lessee may pool or unitize the lease only by obtaining a Communitization Agreement with the State
- Communitization agreement form available at www.colorado.gov/statelandboard
- State may segregate the lease and only commit a portion of the lease into the unit or pooled area

Montana

- Must obtain written consent of the state to pool or unitize the leased lands
- Production from any part of the pooled or unitized lands will maintain the lease

New Mexico

- Unitization: Must submit application to the Commissioner
- Application must contain a statement of facts
- Pooling: Can force pool surrounding lands through a forced pooling order by the oil conservation division

North Dakota

- Must obtain consent of the Land Commissioner to pool the lease.
- Pooling agreement policy:
 - Establish spacing unit or plan of development
 - Can appeal a denial of a pooling request
 - Specific terms of the pooling agreement will be approved by the Land Commissioner
- Pooling does not sever the lease

Oklahoma

- Statutorily authorized to pool the land covered by the lease with other adjoining land for the purpose of joint development and operation of the entire consolidated unit
 - Must first obtain permission from the Land Office

Texas

- Public School Land
 - Pooling must be approved by the School Land Board
- Relinquishment Act Lands
 - Pooling must be approved by the School Land Board, surface owner has no power
- University Lands
 - Pooling must be approved by the University Board
 - Pooling must be in the Permanent University Fund's best interest
- Lands owned by Departments, Boards and Agencies of State
 - Must receive approval from the Commissioner of the GLO
 - Cannot force pool state lands, but state can force pool its way into a unit.

Utah

- Unitization: Requires written consent of the state to commit the leased lands to a unit or other plan of development
- Submit pooling or communitization agreement to assistant director for oil and gas
- Lease is not severed by entering into a unit.

Wyoming

- Unitization: Must obtain consent from the Director of OSLI to enter into a unit plan for exploration development, operation, and production
 - OSLI can also require the lessee to enter into a unit agreement to protect the state's interest
- To apply for unitization, a lessee must submit:
 - Two copies of the draft agreement for approval
 - Schedule of interest ownership by tract, and any governing agreement
 - \$50.00 filing fee

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QUESTIONS?