

# EMENS & WOLPER LAW FIRM, LPA

## Unusual Ohio Oil and Gas Lease Provisions

By: J. Richard Emens

As shale gas activities boom in Pennsylvania and West Virginia in 2010-2011, Landowners in eastern Ohio are being presented with oil and gas leases containing a number of UNUSUAL provisions. Since the dollars offered by mostly out-of-state exploration companies are often larger than recent prior offerings for Ohio oil and gas leases, many Landowners quickly sign these leases without careful review. These unusual provisions will be referred to as UPOGL.

We are concerned for Ohio Landowners (also referred to as "Lessors") who sign these UPOGLs. We expect many of them will discover that they have "sold" more than they bargained for and their future use of their land is severely restricted. UPOGLs also contain many paragraphs not discussed here which need to be fully understood by a Landowner prior to signing a lease.

Key among the UNUSUAL provisions are the following which are listed in the same order as the language typically appears in UPOGLs:

1. Historically, Ohio oil and gas leases provided for the Lessor to have certain rights in oil and gas with the gas referred to being natural gas or dry gas. The UPOGL gives the Lessee the rights to all gas that is associated with coal such as coal seam gas, coal bed methane gas and all other hydrocarbons and non-hydrocarbons contained in or produced or originating from any formation. Use of "non-hydrocarbons" in this context may be claimed to give the Lessee rights to water which may be produced from the land.
2. UPOGLs give the Lessee the rights to conduct geophysical and other exploratory tests. In the past such provisions were usually contained in a separate document for which the Landowner received separate compensation.
3. The "construction" powers of the Lessee in the UPOGL are broader than in previous Ohio oil and gas leases. Not only does the Lessee receive rights to install roads, electric power, telephone facilities, pipelines with pertinent facilities, but also compression and collection facilities for use in the production and transportation of products from Landowners land, AND also from neighboring lands. Thus, by using the "neighboring lands" provision together with the "underground storage of gas" and other provisions (discussed later), the Lessee could have roads and pipelines crisscrossing the Landowners property forever even though there is no oil and gas production on the Landowner's land and the Landowner receives little or no payments.

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4. The UPOGL Lessee will likely claim rights to "non-domestic" water sources free of cost which would appear to mean when combined with the "non-hydrocarbon" rights previously mentioned, that the Lessee can take whatever water it wants from the Landowner's land free of cost.
5. UPOGLs give the Lessee gas storage rights which historically have been the subject of another document for which there was considerable compensation paid to the Landowner.
6. The use of the words, "to drill across, through and under the leasehold," in the granting clause of a UPOGL is especially troubling from the Landowner's standpoint. With horizontal drilling, a Lessee could drill under a Landowner's property for hundreds or thousands of feet, but produce mostly from other lands, and pool only a few acres of our Landowner. Thus, the Landowner would receive only a very small part of the royalty from production from the well.
7. The acreage description in UPOGLs are often much broader as they cover the specifically described acreage and also include "contiguous lands owned by the Lessor" and any other land owned or claimed by Lessor by prescription, possession, reversion, unrecorded instrument or land to which the Lessor has a preference right of acquisition.
8. The UPOGL term clause contains several relatively new and onerous provisions. Whereas older Ohio oil and gas leases provided that a lease would be extended beyond the primary term by oil and gas production, the UPOGL provides that the Lessee gets to determine whether a well is "capable of production".
9. In addition, the UPOGL is extended beyond the primary term if the lease or lands pooled or unitized with the leased lands is used for "underground storage of gas or the protection of stored gas"!
10. The lease term may also be extended beyond the primary term in UPOGLs even if there is no production "if prescribed payments are made". While the quoted words sound harmless, we will subsequently identify what their real meaning is, especially when combined with the provision that if there is any dispute concerning extension of the lease beyond the primary term "the payment .... of the prescribed payments shall be conclusive evidence that the lease has been extended beyond the primary term".
11. The UPOGL often contains an additional provision for extension of the primary term by giving the Lessee the option to extend the lease for an additional period for an "amount equal to the initial consideration given for the execution hereof". While sounding straightforward, typically the "initial consideration" for signing the lease was only \$10.00 or \$100.00. Any substantial bonus was paid later pursuant to "an Order of Payment" 90 or 120 days after the original execution of the lease.

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Thus, the Landowner who believes that he will receive large sums if the option is exercised is likely to be disappointed.

12. UPOGLs contain language that basically negates the importance of "drill or pay" language of older Ohio leases. Under the older leases, if the Lessee did not drill or pay (delay rental) within the specified time, the oil and gas lease expired. UPOGLs have specific language so that the term clause shall "never" be read as language of "limitation" and the lease is to be construed against termination, forfeiture, cancellation or expiration.
13. Under the UPOGL not only is the lease extended beyond the primary term while the Lessee is "conducting operations" but those words include geophysical and other exploratory work as well as preliminary or preparatory work, the Lessee's "internal technical analysis", etc., etc.
14. The UPOGL requires the Lessor to give 60 days' notice of any attempt to terminate, cancel or cause expiration of the lease and the 60 days is "from the receipt of such notice" by the Lessee; if the Lessee timely responds to the Lessor's demand, "such a response shall be deemed to satisfy this provision" so that the lease is not terminated, cancelled or expired.
15. While there is a delay rental paragraph in most UPOGLs, Landowners should not be misled into thinking they will receive any additional payment during the primary term because typically the lease spells out that it is a "Paid Up Lease" and no further delay rental will be made. The main purpose of the delay rental clause in a UPOGL "Paid Up Lease" is to provide how much money a Landowner would receive for a delay in marketing or shut-in gas well payment.
16. Landowners with a prior mortgage may be surprised to learn that any and all payments the Lessee is obligated to make to the Landowner can be suspended by the Lessee until the Landowner obtains at its own expense a subordination of the mortgage in a "form acceptable to Lessee".
17. There is specific language in the UPOGL whereby the Lessor agrees that the payment terms and bonus payments are final and the Lessor will not try to seek additional consideration based on any differing terms which the Lessee negotiates with any other Lessor or Landowner. Thus, a farmer who leases his farm on Wednesday morning for \$X per acre and learns later that day that his neighbor has leased for \$XXXX per acre is stuck with \$X he received. Landowners may wish to stay in touch with their neighbors even though the prospective Lessee will be urging each Landowner to sign and keep the payment information confidential (giving the impression that the Landowner is receiving the highest available dollar amount).
18. UPOGLs typically provide that pooling or unitization may be done by the Lessee or "by others" "before or after drilling" of lands "whether contiguous or not

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contiguous, leased or un-leased". Historically Ohio oil and gas leases gave the Lessee the right only to pool or unitize prior to drilling of contiguous lands where the Lessee owned all the oil and gas leasehold rights. This broadening of the Lessee's rights can be devastating to the Landowner when only a small part of his lease is included in a much larger pooled unit resulting in the Landowner receiving a very small royalty payment but having his entire lease kept in effect by production from the pooled unit.

19. The UPOGL's limitation on the Landowner's ability to build, plant trees, or modify or restrict roads and facilities built by Lessee, when combined with the broad authority of the Lessee to build structures, roads, pipelines, compression and collection facilities can drastically limit the Landowner's ability to utilize his land.
20. The UPOGLs use of the delay rental amount as a measure of payment by the Lessee for gas storage and protection of gas storage severely reduces the compensation a Landowner might otherwise receive for gas storage and protection of gas storage rights.
21. The UPOGL provision allowing the Lessee to drill and/or re-enter existing wells for the disposal and/or injection into "any subsurface strata" (other than a potable water strata) of various substances from any source for any period including after the primary term for \$1,000 per year deprives the Landowner of adequate compensation for this activity.
22. The specific language in the UPOGL negating implied covenants (and especially the implied covenant to further develop) is clearly different from earlier Ohio oil and gas leases. This UPOGL paragraph when combined with other UPOGL language could result in only 1 well on 1,000 acres; because of the non-contiguous pooling authorization the 1,000 acres could include parts of 50 different Landowners land with each having only 2% of the 1/8<sup>th</sup> royalty from a producing well resulting in a tiny royalty payment.
23. Another unusual UPOGL provision gives the Lessee a right of first refusal to match an offer to lease made by a third party; the paragraph effectively removes any opportunity an unhappy Landowner might have to get rid of an existing UPOGL and lease to another oil and gas company.
24. The UPOGL contains specific language stating that "no oral...representations or promises have been made or relied upon...as an inducement..." It is apparent from discussions we have had with unhappy Landowners who have signed a UPOGL why this language is included.
25. The surrender clause of UPOGLs is different than historic Ohio leases as it not only provides that the Lessee is relieved of all obligations under the lease, but that the Lessee shall continue to have "convenient" easements for existing wells, pipelines, roadways and other facilities on the lands surrendered!

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26. Because the UPOGL is "printed" and the Landowner is often told by the prospective Lessee that this is a "Standard" lease, Landowners often sign a UPOGL without fully understanding the meanings and the implications of the more than 4,000 words contained in the UPOGL.
27. An "Order of Payment" is often attached to the UPOGL which is different from older Ohio oil and gas leases. The practice of utilizing an "Order of Payment" effectively gives the Lessee an "option" for a very small amount of money "typically \$10.00 or \$100.00", for a period of 90 or 120 business days to decide whether the Lessee wants the lease or not. The Order of Payment not only gives the Lessee the right to surrender the lease with no negative penalties, but ties up the Landowner's land without significant payment while preventing him from leasing to anyone else during the 90 to 120 business days.
28. The UPOGL is so one-sided in favor of the Lessee it might be anticipated that a court would set the UPOGL aside based upon a lawsuit filed by a Landowner, but this appears unlikely as many UPOGLs contain an arbitration clause taking away the Landowner's choice of going to court.
29. Some UPOGLs contain no limitation on the size of the oil or gas development unit; some provide for formation of an oil and gas development unit of not more than 640 acres. With the negation of the implied covenant to develop and the pooling authority describe previously there may be large one well development units resulting in the Landowner having much smaller royalty payments or fewer wells than in the past.

### CONCLUSION:

The oil and gas leasing occurring in eastern Ohio presents Ohio Landowners with many "new" and extremely burdensome lease provisions. While the dollar amount of the per acre lease bonuses have not been seen in Ohio since the Morrow County Boom many years ago, the larger sums may blind Landowners to the problems that will likely arise. Because of difficult economic times, UPOGLs are often signed by Landowners without any attempt to negotiate the removal and/or reduction of the onerous provisions.

Some of the UPOGL provisions are attempts to avoid the Ohio Revised Code language which can be helpful to Landowners; this language should also be considered when reviewing a UPOGL. It is hoped that Landowners being presented with UPOGLs will fully understand the provisions and attempt to have the most difficult language revised or removed.

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### **LEGAL ACTIVITIES:**

Mr. Emens is a partner in the Emens & Wolper Law Firm, LPA, whose major areas of practice are Business Planning, Oil and Gas Law, Corporate Law, Wills and Trusts and Family Owned Businesses. For more than forty years, he has counseled numerous clients on business and oil and gas issues including oil and gas leases, acquisitions and sales, and represented many clients before state and federal regulatory agencies.

The well known reference book, "Best Lawyers in America," lists Mr. Emens in Corporate Law, Oil and Gas Law and Natural Resources Law.

### **OIL AND GAS ACTIVITIES (Current and Former):**

- President and Trustee of the Energy and Mineral Law Foundation.
- Chair of the Ohio Bar Association Oil and Gas Committee.
- Ohio Oil and Gas Association Trustee.
- Instrumental in drafting Chapter 1509 of the Ohio Revised Code, Ohio's first comprehensive Oil and Gas Conservation Law.
- Appointed by the Governor as the first Attorney member of the five member Ohio Oil and Gas Board of Review (now Oil and Gas Commission) and served for 10 years.
- Wrote all the Oil & Gas Board of Review opinions for ten years.
- Speaker and author of articles on oil and gas law.

### **PROFESSIONAL ACTIVITIES:**

Mr. Emens is a member of The American Bar Association and the bar associations of the States of Ohio and Michigan and admitted to practice in Ohio, Michigan and before the U.S. Supreme Court. He has served as board member, officer and/or member of numerous professional and business organizations.