

Taking Charge of Your Community's Future

Mineral Leasing Questions

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April 2012

The following discussion is based on questions posed at a series of Extension educational sessions held in western North Dakota during January and February, 2012.

*This discussion is not a substitute for legal advice.
Persons are urged to seek professional counsel for answers to their specific questions.*

At what point should I find out whether I own mineral rights?

Now. It is imperative that individuals know what property rights they own.

What process can be used to determine ownership of mineral rights?

Mineral rights are treated the same as any other property right in land and thus their ownership is a matter of public record in the office of the Register of Deeds for the county where the land is located. Surface owners who hold the abstract for the tract may want to incur the cost of having the abstract updated, including all transactions affecting the mineral rights. Thereafter, it is prudent also to incur the cost to have an appropriate professional (e.g., attorney) interpret the record of ownership. Persons who do not have the abstract (such as the owner of severed mineral rights) will likely need to spend time in the county office reviewing the public record or hire someone to conduct a search of the title in the public record.

Who might own the mineral rights if they are not owned by the surface owner?

Mineral rights that are not owned by the surface owner are sometimes referred to as severed rights because they have been separated or severed from the surface rights. Common owners of severed mineral rights include the federal government, state government, the railroad, lending institutions, and individuals.

A variety of scenarios lead to situations where the mineral rights have been severed from the surface. Federal and state governments may have owned land in the past (including the mineral rights) and sold the surface rights but retained the mineral rights. Some individuals have retained mineral rights when they sold the surface rights and these mineral rights then transfer to family heirs. The federal government granted land (often including the minerals) to the railroads as the Great Plains were settled; the railroad may have retained the minerals when the surface rights were sold. Some lenders acquired land from borrowers (maybe through a foreclosure) and then sold the surface but retained the minerals.

When the minerals are developed, the owner of the mineral rights are entitled to share in the value of the minerals, such as government, railroads, absentee mineral owners, lenders and others who own mineral interests.

How is ownership of mineral rights under a town or city handled?

The mineral rights under a municipality are handled the same way as mineral rights in a rural area. The minerals may or may not be owned by the surface owner; the minerals may be owned by individuals, a government entity or a business. The primary difference may be that because the surface land has been divided into numerous small tracts, the minerals also may be owned in small units by many individuals. In the 1980s & 1990s, the time-consuming, but necessary process of identifying the ownership of mineral rights in the City of Dickinson was completed, for example.

If mineral rights are owned by a number of family members, is it advisable to have a family mineral trust?

Each family, in consultation with appropriate professionals, needs to determine how it wants to manage co-owned assets, including mineral rights. The most appropriate strategy for one family may not be the most appropriate strategy for another family.

What happens to severed mineral rights if mineral owner cannot be found?

Property rights, including severed mineral rights, remain the property of the owner even if the owner has not developed or leased out the mineral interest. When the owner dies, the mineral rights will transfer to the heirs. A challenge arises when the family is unaware that the deceased relative owned severed mineral interests and thus the family does not explicitly transfer the rights to the heirs. In such a situation, the rights still transfer – it just has not been clearly documented. With the passage of time and several more deaths, tracking “who should be the owners” and clearing the record of ownership becomes difficult.

As a partial remedy in this situation, North Dakota law ([N.D.C.C. chap. 38-18.1](#)) states that an abandoned mineral interest can become the property of the surface owner. This law has not been interpreted by the North Dakota Supreme Court and there are those who consider this law unconstitutional. However until the law is challenged in a court proceeding, the statute is considered legitimate.

This statute states that a mineral right is not considered abandoned if, within the last 20 years, it has been used by the mineral owner, such as, minerals were produced, the mineral rights have been leased, or the mineral owner has filed a statement of claim. If the surface owner intends to take ownership of the abandoned mineral interest, the surface owner needs to attempt to notify the mineral owner and proceed with a quiet title action in district court. Suggestion:

- Owner of severed mineral rights: file a statement of claim every 20 years.
- Owner of surface rights where the mineral rights have been severed: follow the procedure outlined in the statute to claim ownership of the abandoned mineral rights.

Is the state regularly filing claims to retain rights on state-owned mineral rights?

This statute does not pertain to government entities so the state has no need to file statements of claim.

Can a surface owner who also owns the mineral rights lose those mineral rights?

No.

When an oil company offers a lease to a mineral owner, might there be other entities also interested in leasing the minerals?

Yes. “Shop around” and “do your homework” before you sign a mineral lease. Be patient. Mineral owners do not have to “jump on” the first lease that is offered. Prudently study the offer and possible alternatives.

Are some entities and individuals attempting to acquire mineral rights in hopes of earning a profit by subleasing the rights to another company?

Sure. Everyone is looking for an opportunity. Mineral owners need to be aware of who they are negotiating with – it may be an oil company that is interested in leasing the minerals with the intent of producing the minerals, or it may be an individual or an entity that is willing to assume the risk of leasing minerals in hope of subsequently subleasing the minerals to an oil producer. A mineral owner should ask the person who has approached them to explain their intentions. If the mineral owner is not satisfied with the explanation, the mineral owner does not need to do business with that person or entity. Be patient.

Likewise, mineral owners are not required to lease or sell their mineral rights. If a mineral owner is not satisfied with the offer they have received, they can reject it and wait for (look for) another offer. Mineral owners do not “need to accept the offer and take the money now” if they are not satisfied.

Mineral and surface owners should be cautious when transferring property rights. Do not inadvertently transfer away mineral rights, such as transferring ownership when you thought you were only leasing them. Be cautious not to include mineral rights when granting a mortgage in which you intend to only encumber the surface rights. Likewise, be cautious to not transfer more rights as an easement than you want to or than is immediately needed by the entity acquiring the easement. Have a lawyer review your documents before signing them to assure you know what rights are being transferred and that the document accurately describes the rights you intend to transfer.

What might a mineral owner do to make their mineral interests more attractive to a mineral developer?

Probably not much. If a mineral developer is not interested in producing in your area at this time, there probably is not much that can be done to bring them to your area. As people in southwestern North Dakota learned in late 2011, interest in leasing mineral (even by those who are speculating in mineral rights) ends immediately if the oil producers “signal” that they have no interest in developing minerals in the area at this time.

When can a mineral owner renegotiate a mineral lease?

Mineral leases specify a period of time, for example, three or five years (as negotiated by the mineral owner and mineral developer) during which time the mineral developer has the right to explore for and begin producing oil. If no production occurs, the lease will expire at the specified time and the mineral owner can negotiate a new lease. In this regard, leasing mineral rights is similar to leasing the surface rights to grow a crop or graze livestock. The agreed upon time period in a mineral lease is referred to as the “primary term.”

If the mineral developer initiates production during the primary term, the lease agreement will remain in effect as long as the mineral developer continues to produce oil from those mineral rights. This “extended term” could last for several decades! Negotiate a mineral lease as if it will outlast you; if production is commenced, the lease could easily last beyond the life of the current mineral owner.

A mineral lease is considered “extended” when “**operations**” are commenced. Accordingly, the mineral owner will want to define “operations” in the mineral lease. For example, the State of North Dakota mineral lease states:

- “If no well be commenced ... this lease shall terminate”
- “If, at the expiration of the primary term, production of oil and/or gas has not been obtained in commercial quantities ... but drilling, testing, completion, recompletion, reworking, deepening, plugging back, or repairing operations are being conducted ... in good faith, lessee may ... file a written application ... for a one hundred eighty (180) day extension of this lease, such application to be accompanied by a payment of ten dollars (\$10.00) per acre...”

Some mineral developers are willing to enter into a lease agreement before the current mineral lease expires. This is a mechanism by which a second mineral developer assures it has the right to proceed as the mineral developer as soon as the current mineral lease expires. Entering into a future lease before the current lease expires is referred to as “**top leasing**” or a “**top lease**”. Negotiating a top lease is an opportunity for the mineral owner to renegotiate, but it is based on the assumption that the current mineral lease will expire at the end of its primary term.

How are mineral interests managed if they are owned by more than one person, such as landowner A owns 50% of the underlying minerals and the other 50% is owned by person B?

Each mineral owner is entitled to manage their mineral rights. For example, landowner A might enter into a lease agreement with mineral developer M and person B might 1) not lease their mineral interest, 2) lease their mineral interest to mineral developer S, or 3) also lease their mineral interest to mineral developer M. How A manages his or her mineral interest has nothing to do with how B will manage their mineral interest.

If mineral developer M wants to develop A’s mineral interest (based on the mineral lease between A and M), M will probably contact B and offer a mineral lease. If B has not leased the mineral interest to another mineral developer, B can accept or reject M’s offer. If B has already leased the mineral interest (perhaps to mineral developer S), B has nothing to lease to M.

If S has already leased B’s mineral interest and M has leased A’s mineral interest, S and M (both oil companies) will negotiate how they will collaborate to drill a well. Both are not going to drill a well; with today’s technology, that is probably inefficient. The North Dakota Industrial Commission will expect S and M to reach an agreement as to which company will operate the well and then grant a drilling permit to that mineral developer.

The oil from the well will be divided between mineral developers S and M, and M will have to be certain that A receives his or her royalty share (based on the mineral lease between A and M) and S will need to be certain that B receives their royalty share (based on the mineral lease between B and S).

If there are multiple mineral owners, does the developer need to contact all of mineral owners?

Mineral developers are expected to identify and attempt to contact the mineral owners. For example, a mineral developer is expected to make a good faith attempt to lease an unleased mineral interest (see N.D.A.C. 43-02-03-16.3(1) at <http://www.legis.nd.gov/information/acdata/html/..%5Cpdf%5C43-02-03.pdf>). This regulation illustrates the expectation that a mineral developer attempt to identify and contact all mineral owners as a well is being established.

Can an owner of a partial mineral right stop development of the minerals?

No. As long as a mineral owner is interested in having the minerals developed (that is, has entered into a mineral lease with a mineral developer), the minerals can be developed by the oil company. For example, a person who owns only a portion of the mineral estate (e.g., 25% and the other 75% of the mineral rights are owned by someone else) can develop the minerals without agreement from the other mineral owners or the surface owner. The other mineral owners will be compensated for their share of the mineral interest.

The law (and this is an old, well-established legal concept) allows the mineral owner to develop his or her mineral rights, otherwise, their property (their mineral rights) have no value.

How would a mineral owner share in royalty income if the mineral owner has not signed a mineral lease?

State law mandates that "An unleased mineral interest ... is entitled to a cost-free royalty interest equal to the acreage weighted average royalty interest of the leased tracts within the spacing unit or, at the operator's election, a cost-free royalty interest of sixteen percent" (see N.D.C.C. 38-08-08(1) at <http://www.legis.nd.gov/cencode/t38c08.pdf>).

Will a mineral owner share in the ownership of the well if mineral owner does not sign a mineral lease?

Yes. After receiving the 16% royalty, the unleased mineral owner will share in the ownership of the well. However, the mineral owner a) shares in the cost of the well, b) is required to pay the operator of the well a 50% penalty for not assuming the risk of drilling the well, and c) will not receive a bonus payment.

What happens to the royalty payment if the mineral owner cannot be found?

The mineral developer is required by state law to deposit the royalty payment into a trust fund maintained by the county. The mineral developer can request that the court establish a trust for the unlocated mineral owner but the mineral developer must first make a diligent effort to locate the mineral owner (see N.D.C.C. 38-13.1-01 at <http://www.legis.nd.gov/cencode/t38c13-1.pdf>). 50% of the amount deposited immediately transfers to the county. The other 50% is held for the mineral owner but is subject to North Dakota abandonment law, that is, the cash transfers to state ownership.

Will an oil company choose to lease from one mineral owner over another mineral owner based on the bonus payment and royalty share each mineral owner is demanding?

Maybe, but the oil company will probably want to lease all the mineral interests (*as mentioned above*). Even if the oil company does not lease a portion of the mineral interest, the oil company still needs to pay the royalty (*as mentioned above*).

In horizontal drilling, if the well passes through land owned by someone who has not given permission or leased their minerals, how is that oil not collected?

The oil is collected and the mineral owner is paid (*as an unleased mineral owner as mentioned above*).

Current horizontal drilling technology means that the oil produced from one well often is being drawn from mineral interests held by several mineral owners. For example, much of the drilling in North Dakota is going down about 10,000 feet to reach the desired geological strata. The drilling process then turns and drills horizontal about another 10,000 feet (two miles).

A horizontal well bore will probably be needed every (approximately) 600 feet. Thus, we can envision a line of 7 or 8 wells along one edge of the 1280-acre tract where each well drills 10,000 feet down and then 10,000 feet horizontally in parallel bores to lay out an underground network to harvest the oil from those 1280 acres. Currently, the first well is being drilled in many of the 1280-acre tracts (to lock in the mineral rights with an *extended lease*) with expectations that additional wells with parallel horizontal bores will be drilled in the future.

To administer the mineral interests, the Industrial Commission designates two square miles (about 1,280 acres) as a spacing unit. The boundaries follow the section lines on the surface. All mineral owners in those two sections share in the oil produced from wells operating in those two miles.

As part of the permit to drill the well, the oil company needs to determine the ownership (and leases) for all mineral rights in that 1280-acre. All mineral owners will then share in the production from the current well and future wells that are "harvesting" the oil from those 1280 acres.

When horizontal drilling, whose responsibility is it to let the mineral owner know if they are crossing the owner's rights, or is it the owner's responsibility to track the development process?

It is the oil company's responsibility but mineral owner can and should take an active role. This process is overseen by the Industrial Commission which means the much of the information is available at the agency's web site. The Industrial Commission's process of granting a drilling permit involves the mineral developer identifying the mineral owners.

How would one determine whether a negotiated lease is good or reasonable? Should the mineral owner contract an attorney? Would the ND Industrial Commission be able to provide any advice?

A mineral lease is a contract between two private entities, no different than negotiating an agricultural lease or a car purchase. The mineral owner needs to determine whether he or she is satisfied with the offer. The Industrial Commission has no role in helping mineral owners assess the acceptability of an offered mineral lease.

There is no such contract as a "standard mineral lease" even though that idea may be suggested.

The State of North Dakota owns mineral interests and thus enters into lease agreements with mineral developers. The Department of ND Trust Lands has a sample mineral lease on its web site (<http://www.land.nd.gov/minerals/Docs/leaseform.pdf>). Mineral owners may want to review this sample as part of preparing to negotiate a mineral lease. Retaining professional legal counsel also is **strongly recommended**.

The bonus rentals being paid to the state is public information through the Department of ND Trust Lands web site.

Who regulates the oil company as oil is being extracted?

The Industrial Commission regulates oil production. The mineral developers are required to report production data; the data can be confidential for the first six months; thereafter, it is public information. The Industrial Commission also regulates the company's activities, such as spills and clean-up. Visit the Industrial Commission's web site.

How do mineral owners know whether they are being paid the correct amount of royalty?

As stated previously, oil producers are required by state law to inform the Industrial Commission as to production and these data are available to the mineral owner and the public. The data are available on the Industrial Commission web site. Mineral owners also receive regular statements from the mineral developer as part of the royalty payment.

What obligations do "implied covenants" impose on the mineral developer?

Mineral leases often require the mineral developer to produce the minerals, protect the mineral interests from production by competing oil producers, and manage the lease agreement. These obligations are considered the basic responsibilities of a mineral developer who has leased the mineral interests.

If a producing well is shut down by the mineral developer, will the mineral owner "get the mineral rights back?"

Yes, the mineral lease ends when production is no longer occurring; that is the extended lease ends when production is stopped (assuming that the time for the primary term has passed). However, some mineral leases allow the mineral developers to retain the mineral rights even though production is not occurring by paying the mineral owner a "shut in royalty" to compensate for the royalty that is not being generated from production.