

Oil and Gas Leasing in Montana: Tips and Questions for Landowners



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Overview

1. The importance of leasing
2. Oil and gas development in Montana
3. Leasing and leases
4. Other contracts, concerns, and topics



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Landowner	Landman
<ul style="list-style-type: none"> • <u>You</u> need to look out for you. • Think about your priorities—short and long run. • Understand your options. 	<ul style="list-style-type: none"> • Paid to get signed leases. • May or may not work for developer. • Always negotiating: familiar with details of leases and recent trends.




Benefits of Attention to Leasing Details

Do you want this?



Photo: Water Watch Alliance

Or this?



Photo: BLM Gold Book




Benefits of Attention to Leasing Details

Do you want this?



Or this?



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Long-term Contracts

- Most leases are “held by production”
 - A lease signed this year might remain in effect for 40 or more years
- Opportunity may not knock twice
- Leasing stipulations



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What do you own?

- Unified Estate
 - Surface and all minerals
- Mineral Ownership
 - Whole or fractional mineral
- Royalty Ownership
 - Fractional
- Surface Only



Surface



Minerals

What you think about leasing depends on your point of view

- **Mineral Owner**
 - Financial return possible
 - May offset impacts on surface (if you own)
 - Whole or fractional owner

What you think about leasing depends on
your point of view

- Mineral Owner
- **Surface Owner**
 - Can't prevent development
 - Minimal (if any) return
 - Concern about impacts on agriculture



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What you think about leasing depends on
your point of view

- Mineral Owner
- Surface Owner
- **Agricultural Lessee**
 - Financial return unlikely
 - Surface impacts meaningful



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What you think about leasing depends on
your point of view

- Mineral Owner
- Surface Owner
- Agricultural Lessee
- **Neighbor**
 - Financial return
 - Surface impacts may be meaningful
 - Protect your own property



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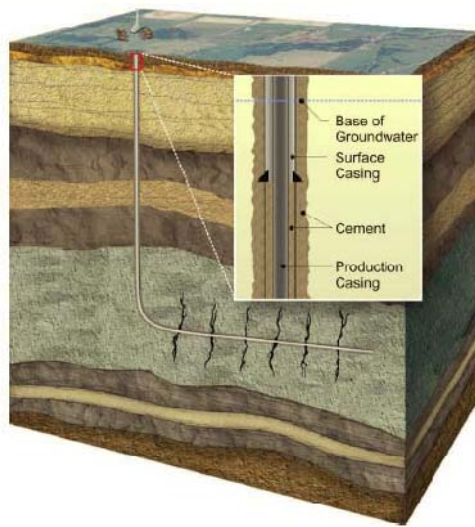
Oil and Gas Development

- Technological advances
 - Directional drilling
 - Hydraulic fracturing
 - Advanced seismography
- Montana is still a marginal state for production, but that is changing
- Prices are strong (for oil, not gas)



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New Technical Realities



Poorer Resources & Technical Change

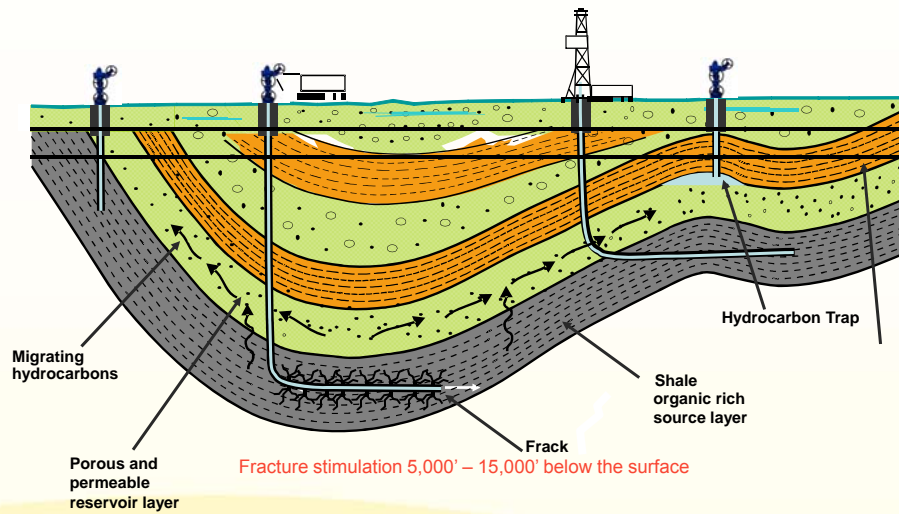
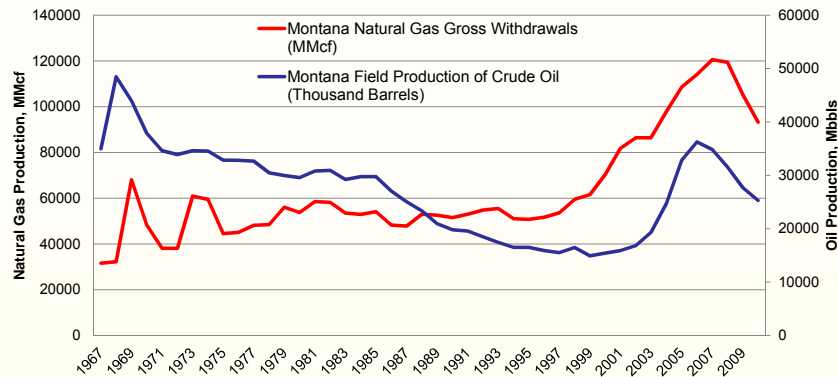


Image courtesy of Devon Energy

Oil and Gas History in Montana

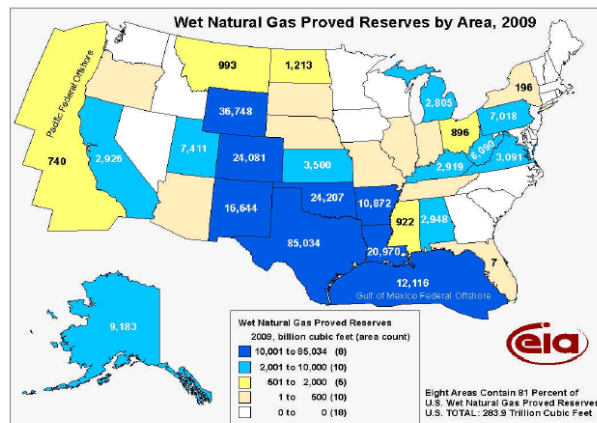
Montana Annual Oil and Natural Gas Production
1967-2010



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Natural Gas: Montana \approx Mississippi \approx Ohio

Figure 5: Wet Natural Gas Proved Reserves by Area, 2009



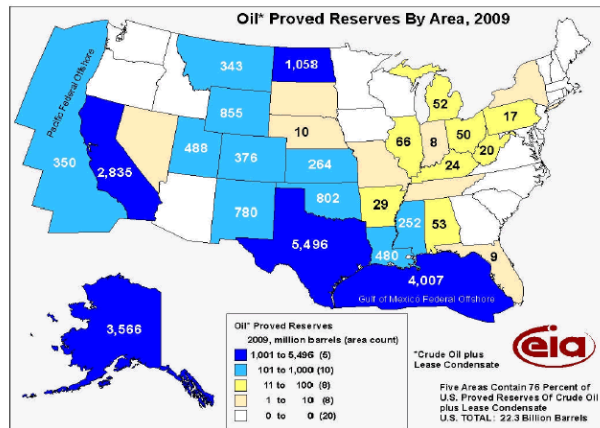
States with a color but no value displayed above are intentionally unlabelled for confidentiality reasons.
Source: U.S. Energy Information Administration



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Oil: Montana ≈ Colorado

Figure 9: Oil Proved Reserves by Area, 2009



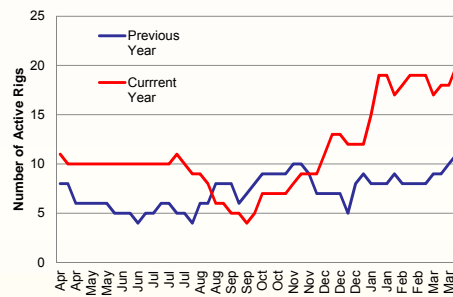
States with a color but no value displayed above are intentionally unlabelled for confidentiality reasons.
Source: U.S. Energy Information Administration



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Activity in Montana

Baker Hughes Rig Count
Montana: April 2010- March 2012

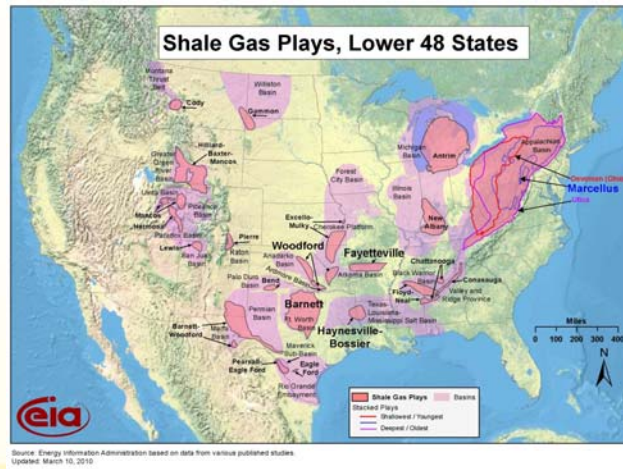


20 rigs last week: 11 Richland, 6 Roosevelt,
1 each in Sheridan, Dawson, Teton

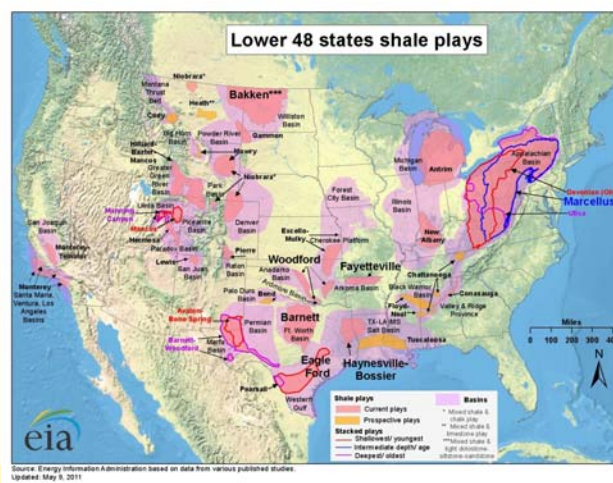


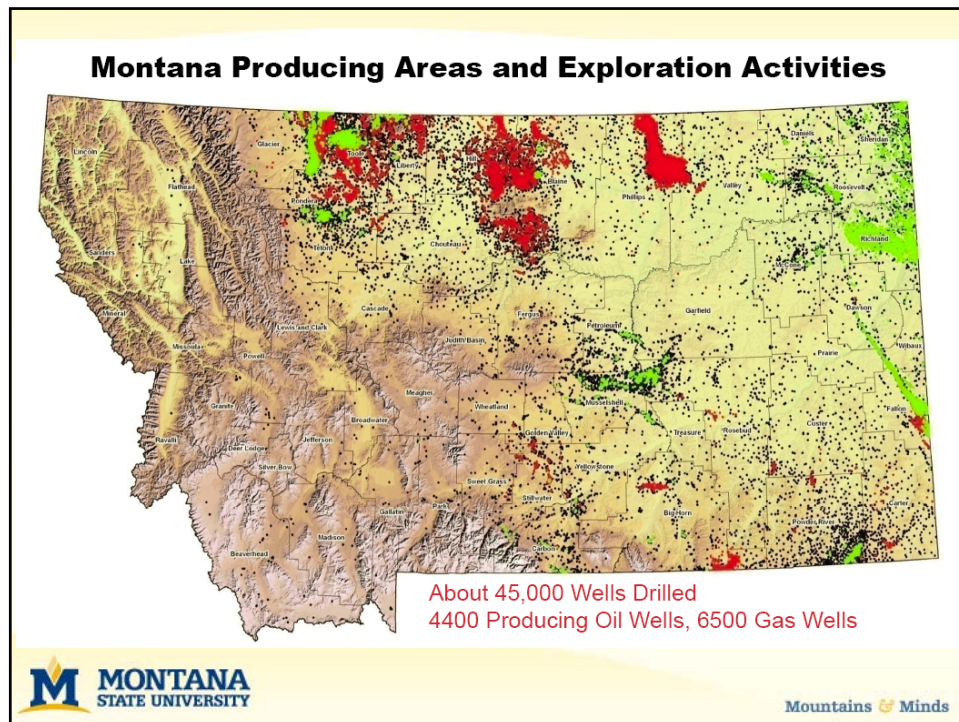
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2010 Shale Gas Map



2011 Shale Gas Map





The Leasing Process

1. Offer arrives in the mail...
2. Counter-offer, negotiation
3. Consult an attorney with expertise in oil and gas
 - May or may not be your personal/ranch attorney
4. More negotiation
5. Lease signed

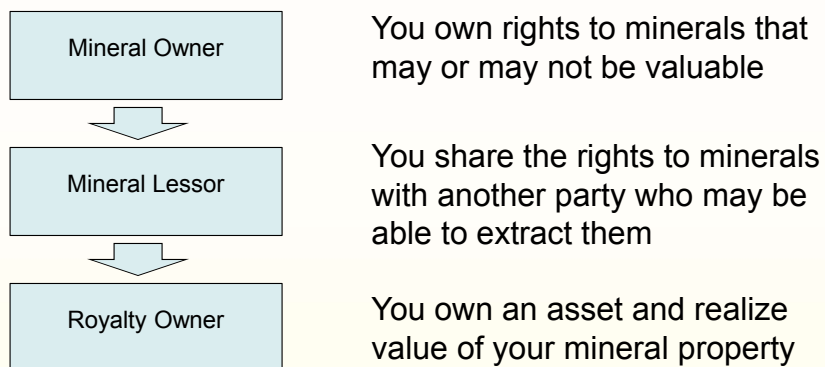
The Development Process

1. Lease acquisition
 - May or may not done by developers
2. Seismic/other exploratory activity
3. Well construction
 - Other infrastructure: pipelines, servicing
4. Production phase
 - Division orders
 - Interim reclamation
5. Final reclamation



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How Your Role Changes Over Time



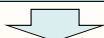
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What You Have to Do

Mineral Owner



Mineral Lessor



Royalty Owner

Negotiate and sign a lease

Verify and sign a division order
(usually, and only if production occurs)

Standard Lease Payments

- Bonus
 - Upfront payment received for signing the lease
- Royalty
 - Percentage of production value received, if production occurs
- Rental
 - Annual payment received between signing and production

Main Parts of a Lease

- Granting Clause
- Duration
 - Extension
- Royalty
- Surface Damage
- Assignment Clause



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The Lease **Granting** Duration Royalty Surface Damage Assignment

Granting Clause

- Details what is being leased—be specific.
- Separate consent for seismic?
- Specify what rights lessee does and does not have (i.e., will have to pay extra for later).



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The Lease **Granting** Duration Royalty Surface Damage Assignment

Water

- Your water is your water
 - lease it separately
- Don't permit access to water as part of the land



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The Lease Granting **Duration** Royalty Surface Damage Assignment

Duration

- Primary term specified is leased for sure
- Secondary term, or “an option” for additional years
- Lease may be “paid-up”
 - no delay payment (or second bonus payment) will be made
- May be provision for surrendering lease, thereby avoiding rental payments.



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The Lease Granting **Duration** Royalty Surface Damage Assignment

Duration Extensions

- In general leases are “held by production”
- Dry hole: usually gives 90-day window to hold the lease
- Shut in: well drilled, found mineral, but is currently not producing
 - A “shut-in” payment (like rental) included
- Cessation of production: allows producer to employ dry hole or shut in rules when production stops



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The Lease Granting **Duration** Royalty Surface Damage Assignment

Modified Pugh Clause

- Allows owner to release acreage that would otherwise be held by production
 - One well on a 3,000 acre ranch—
Pugh clause forces lessee to surrender other acreage, which can then be leased again



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The Lease Granting Duration **Royalty** Surface Damage Assignment

Royalty

- What is amount of royalty interest?
- Time, calculation, minimum royalty payment
 - Quarterly, monthly
 - What price determines value?
- In-kind royalties—may be some on-farm use, but otherwise not attractive



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The Lease Granting Duration **Royalty** Surface Damage Assignment

Overriding Royalties

- Royalties may be reduced for “post production costs” or other fees.
- “Overriding royalty” is a way to avoid paying these costs.
- E.g., offer 12.5% royalty, with a 7.5% overriding royalty.



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The Lease Granting Duration **Royalty** Surface Damage Assignment

Tradeoffs

- Higher royalty → lower bonus
- More non-monetary concessions → lower royalty
- Other types of stipulations come with a tradeoff as well



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The Lease Granting Duration Royalty **Surface Damage** Assignment

Surface Damage

- Mineral owner can specify terms of surface use and compensation for surface damage
- Some owners sign this as a separate contract once drilling is ready to commence



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The Lease Granting Duration Royalty **Surface Damage** Assignment

Surface Damage

- Require reclamation—interim and final
- Will surface facilities be used to service production from other lands?
- Disputes to be settled by appraiser



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The Lease Granting Duration Royalty **Surface Damage** Assignment

Surface Use Stipulations

- What else can be specified?
 - Weed control
 - Fences
 - Water development
 - Roads
 - Wildlife
 - Timing



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The Lease Granting Duration Royalty **Surface Damage** Assignment

Baseline Data is Invaluable

- Get the producer to collect it as part of the lease
 - Water quality is the most common concern
- Take pictures (dated digitally)
 - Roads, weeds, fences, etc.



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The Lease Granting Duration Royalty Surface Damage **Assignment**

Assignment

- Require written notification of assignment within specified time
- Hold the original lessee liable for payments and performance, even after assignment
- Check up on assignee



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Split Estate Owner

- Surface owner can sign surface use agreement to cover terms of entry
 - Alternative is to allow entry covered only by bond—“bond on”
 - Surface owner protection is not required on private minerals in Montana



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Surface Use Agreements

- No need to worry about the rest of the terms of the lease.
- Alternative is to allow the producer to “bond on” to the surface.
- Baseline data is critical.



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Pooling

- Leases can be pooled into producing units.
- Depending on the lease, the lessee or the lessor may make pooling decisions.
- In some cases, pooling may remove some control over what happens on your land.
- This can't happen without a good faith private attempt to agree, and a BOGC hearing.



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Division Orders

- Ensure that percentages are correct
- Additional terms may modify parts of lease while division order is in effect
 - You can amend or nullify



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Additional Resources

BOGC: <http://bogc.dnrc.mt.gov/>

BLM: http://www.blm.gov/wo/st/en/prog/energy/oil_and_gas.html

ND Extension: <https://www.dmr.nd.gov/oilgas/leasingconsiderations.pdf>

Texas A&M: <http://recenter.tamu.edu/pdf/229.pdf>

NPRC: <http://www.northernplains.org/the-issues/landowner-rights/>

NARO: <http://www.naro-us.org>

MLMOA: www.mlmoa.org



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To Access Recorded Video

<http://www.montana.edu/softwaredownloads/energydownloads.html>



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CHECKLIST FOR NEGOTIATING AN OIL AND GAS LEASE

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for the Texas Land & Mineral Owners Association
Annual Meeting, October 5, 2006

1. ***Check out the lessee.***

Some leases are acquired in the name of landmen or agents for the true lessee. Insist on knowing the identity of the company acquiring the lease, and that the ultimate lessee be the named lessee in the lease. Inquire about the experience of the company in the area. Learn to use the Texas Railroad Commission website to investigate operator history. Ask other landowners who have dealt with the company. If the company is small and/or owned by one person, consider asking the principal for a guaranty of the lease.

2. ***Agree on Deal Terms First.***

The "deal terms" of a lease are typically:

- bonus,
- primary term,
- royalty fraction,
- delay rental (if any)
- shut-in royalty

Reach agreement on these terms before negotiating the form of lease. Additional "deal" terms may include:

- an option to extend the lease primary term,
- a commitment to drill a well during the primary term, or pay an agreed amount as liquidated damages.
- a promise to pool lands into a unit for a well to be drilled,
- an increased royalty after "payout" of a well,
- a minimum annual royalty.

3. ***The Lease Form.***

Once "deal terms" are agreed, decide whose lease form to start with in negotiations. If possible, use your attorney's form or the TLMA form as the beginning of negotiations. The TLMA form addresses many of the issues described in this checklist.

4. *Negotiate.*

Remember: all lease terms are negotiable. The landman acquiring the lease may not have authority to negotiate those terms, but someone does. Don't be timid.

5. *Bargaining Position*

Your bargaining power in negotiating lease terms depends on

- The size of your tract and what minerals you own in the tract;
- the proximity of your tract to known production;
- whether multiple companies are competing to acquire leases in your area; and
- "going rates" for bonus and royalty in your area.

Often an oil company will designate an area in which it wants to acquire leases, and hires a landman to get as many leases in that area as he can at a set bonus and royalty rate. Once the company has acquired all leases it can at those rates, it may then be willing to negotiate better terms for the owners in the area who have held out for higher rates. Never be bashful about negotiating bonus and royalty rates – it never hurts to ask.

6. *Description of Leased Premises*

Be sure there is a complete legal description. If there is more than one non-contiguous tract to be leased, provide a separate lease for each tract.

Delete the "mother hubbard" clause in printed forms following the lease description ("This lease also covers any lands of lessor adjacent or contiguous to the above-described lands")

7. *Limit the lease to oil and gas.*

Most printed form leases cover "oil, gas and other minerals." Limit the lease to petroleum and natural gas and related hydrocarbons produced in association with oil and gas.

8. *The Royalty Clause*

Prohibit or limit deductons of post-production costs – transportation, dehydration, compression, treating and marketing costs.

Beware of the *Heritage v. NationsBank* trap. Provide that royalties are based on the higher of market value or gross proceeds received by lessee *at the point of sale*, not net proceeds at the well.

Address the sale of production to affiliates of the lessee. If there is an affiliate sale, the royalty should be based on the higher of gross proceeds or market value at the point of sale.

Detail the time, place and frequency of payment of royalties.

Provide for interest on royalties not paid when due, at an above-market interest rate.

Include the right to terminate the lease for failure to pay royalties, after a period of written notice and opportunity to cure.

Include a security interest provision to secure payment of royalties.

Provide for the right to inspect, copy and audit books and records to assure correct royalty payment.

Consider a minimum annual royalty clause of \$25/\$50/acre/year.

9. *Define "Operations."*

Clearly define what is necessary to constitute drilling operations, and when drilling operations are completed.

Define what "operations" will maintain the lease in effect beyond the primary term absent actual production.

10. *Pooling and Pugh Clauses*

Consider whether to grant the lessee the right to pool. If the tract is large enough to develop without pooling with other lands, try to delete the clause entirely.

If a pooling clause is needed, negotiate a maximum size for pooled units.

Consider requiring that a minimum part of the leased premises be put in any pooled unit. If the lease covers 40 acres or less, require that all of the leased premises be included in the pooled unit.

Insist in a "Pugh clause", providing that production from a pooled unit will not hold that portion of the lease not included in the unit.

11. *Continuous Operations Clauses*

The importance of these provisions depends largely on the size of the tract being leased. If the tract is relatively small (less than 200 acres),

such a provision is probably not necessary. For larger tracts, a continuous operations clause requires the lessee to release portions of the leased premises not included within "production units" designated around producing wells, at some time after the end of the primary term. Thereafter, each production unit stands on its own as a separate lease, and production from each well holds under lease only that part of the leased premises within its production unit. Specify maximum unit sizes, and the maximum time between completion of one well and commencement of the next well in order to keep the lease in force as to all lands beyond the end of the primary term (90 or 120 days).

12. *Depth Severance*

Require the lessee to release all depths below the deepest producing perforation at the end of the primary term. If possible, avoid use of the term "stratigraphic equivalent."

13. *Assignment*

Consider whether to require lessor's consent to any assignment by the lessee.

Require notice and copy of any assignment.

Provide that no assignment by lessee will relieve lessee of any liability, before or after the assignment, and that any assignee is jointly and severally liable with lessee for all lease obligations.

14. *Delete the warranty of title.*

15. *Limit the effect of the force majeure clause.*

Require the lessee to give notice in writing of a force majeure event, and provide a maximum number of days beyond the end of the primary term that a force majeure clause can keep the lease in force.

15. *Provide a broad indemnity clause that satisfies the "express negligence" rule.*

16. *Address the use of division orders.*

If possible, provide that lessor is not required to sign a division order in order to receive payment. Provide that no division order will operate to amend any provision of the lease.

17. Protection of Surface

If the lessor owns the surface estate, consider what provisions need to be included to protect the surface estate. These provisions will vary greatly with the type of land involved and its current and prospective uses.

Provide that surface owner will be compensated for all uses of and damages to the surface estate for all operations by lessee.

Consider providing agreed liquidated amounts for specific uses: Agreed amounts for well locations, roads, pipeline easements, tank batteries, etc.

Consider liquidated damages provisions for breaches of particular covenants: \$ ____ each time the lessee fails to close a gate, \$ ____ each time the lessee fails to provide a copy of an assignment.

Remember that a lease may remain in effect for decades. Therefore, if liquidated amounts are specified, provide that those amounts will be adjusted annually based on changes in the Consumer Price Index, to account for inflation.

Provide that employees and agents of lessee may be excluded from the property if they violate restrictions on surface use.

Provide that lessee must consult with lessor in the location of all roads and other facilities, and locate same so as to minimize interference with use of the surface.

If the land is under grazing or farming lease, provide that lessee must separately compensate the surface lessee for all damages caused to such party's leasehold interest and property.

An oil and gas lease carries with it the right of lessee to use subsurface and subsurface water, to use caliche found on the property for construction of roads. Prohibit lessee from using water from lessor's wells or tanks, and provide that subsurface fresh water may be used only for drilling operations, and not for secondary recovery operations.

Require lessee to tender any water well it has drilled to the surface owner when the lessee has no further use for the well.

Require pipelines to be buried below 36 inches, and require lessee to "double ditch" all pipelines and restore the surface.

Address any particular concerns regarding surface use that are unique to your property. Be sure those provisions are in writing and agreed to before the lease is signed.

18. *Well Plugging Insurance*

The Texas Legislature has recently authorized a new form of insurance, whereby an insurance company writes a single-premium policy insuring that a well will be plugged when it is no longer capable of producing. A lease provision requiring the lessee to purchase such a policy for each well it drills is included in the TLMA form.

19. *Access to Information*

Require the lessee to furnish copies of title opinions, drilling permits, drilling and completion reports, and well logs.

20. *A note on the use of bank drafts*

Companies like to use bank drafts to pay lease bonuses. This is convenient for the company, but poses risks to the lessor. First, a draft gives the company a period of time – usually 30 days – after the draft is presented to its bank to decide if it wants to honor the draft and make payment. During that time, it can check the lessor's mineral title to be sure that the lessor has not leased to someone else. But the usual practice is for the lessor to send the lease back to the company at the same time the draft is deposited for collection. The lessor therefore runs the risk that the lessee will record the lease and then not honor the draft. The only way to straighten this out is with a lawsuit. I therefore discourage the use of drafts, and try to insist that the company pay the bonus by check. Usually, the landman will bring the check and exchange it for the executed lease. In that way, the lessor is assured that the signed lease is not delivered until the bonus is paid. If the lessor has any question about whether there will be sufficient funds to pay the check, consider whether you really want to lease to that lessee; if necessary, you can insist on a cashier's or certified check.

OIL AND GAS LEASE

THIS AGREEMENT, made this the _____ day of _____, 20____, by and between: _____, Lessors and parties of the first part, hereinafter called "LESSOR" and _____, party of the second fit, herein called "LESSEE":

WITNESSETH: For and in consideration of the sum of \$_____, paid by the Lessee to the Lessor, the receipt of which is hereby acknowledged and of the covenants and agreements herein contained, Lessor does hereby lease, demise and let unto the Lessee, for its exclusive possession and use, for the purpose of exploring, operating for, producing, removing and marketing oil and gas, or either of them, all of the certain tract or parcel of land and/or oil and gas situated in _____ District, _____ County, West Virginia, bounded substantially as follows:

On the North by-_____
On the East by-_____
On the South by-_____
On the West by-_____

Containing _____ acres, more or less, and being the same lands acquired by the Lessors by deed dated _____ from _____, and recorded in Deed Book No. _____, at page _____, the _____ County Clerks Office in _____ West Virginia.

This lease is made upon the following terms, rents, covenants and conditions, all of which are agreed to by the parties hereto:

- 1. RIGHTS OF LESSEE:** Lesser shall have all rights, privileges and rights of way possessed by the Lessor which are reasonably necessary for the purpose of this lease, including, but not being limited to drilling, reconditioning, redrilling, - completing and operating wells; and grading, constructing, maintaining and using access roads, pipelines, power lines, drips, tank, stations, cathodic protection devices, houses for gates, meters, and regulators, for use in connection with operations upon the demised premises. Lessee may use existing roads or easements over the surface of said lands only with permission of the owners thereof.
- 2. TERM:** This lease shall remain in force for a term of _____ years from the date of the execution hereof and so long thereafter as oil or gas is produced in paying quantities therefrom.
- 3. RENTALS AND ROYALTIES:** The Lessee Covenants and agrees as follows:

- (a) Production Royalty:
(i) Oil:

To pay the Lessor, as royalty for all oil and constituents thereof, produced and saved from any well or wells drilled on the leased premises, an amount equal to one-eighth (1/8) of the price paid to Lessee by the Purchaser of any such oil from the sale of such oil in the tanks, pipelines or other facilities, to which the Lessee may connect its wells. Said royalty shall be paid monthly directly to the Lessor by the purchaser of the oil.

(ii) Gas:

To pay Lessor as royalty for all gas and constituents thereof, including all liquid, solid or gaseous substances produced and saved from any sand or sands and/or formation or formations on the leased premises, an amount equal to one-eighth (1/8) of the price received by the Lessee from the sale of such gas and the constituents thereof at the first good faith, arms-length sale from the Lessee to an unrelated third party without deduction for fees, taxes or expenses of any kind, whether production or post-production. Payment of royalty for gas produced and marketed during any calendar month is to be made within sixty (60) days from the end of the month of production. Notwithstanding any provision herein, gas royalty shall be not less than one-eighth (1/8th) of the Inside FERC Appalachian (Dominion) Index Price, for the month such gas is produced, without deductions.

All gas produced shall be measured by a meter set at the well head and royalty shall be paid on the volume measured accurately at that point. The meter or meters used shall be designed and recommended by the manufacturer thereof for use under the conditions then and there prevailing to a degree of accuracy acceptable in the industry in the sale and transfer of natural gas generally.

(b) Delay Rental Payment:

To pay or tender to Lessor as delay rental at the rate of \$_____ per acre annually, in advance, beginning on the date of this lease and continue thereafter until a well actually yielding royalty from natural gas or oil in paying quantities to Lessor as provided above is drilled on the leased premises.

(c) Free Gas:

The Lessor hereby excepts and reserves from one (1) well on said land producing gas an amount of gas not to exceed two hundred fifty thousand (250,000) cubic feet per year for the use of the surface owner upon whose land the well is situate. It is understood that such free gas installation will be made by Lessor at Lessor's own risk, and Lessor does hereby relieve and release Lessee, its heirs and assigns from all liability in connection therewith.

(d) Manner of Payment:

All payments hereunder may be made directly to the Lessor or by check payable and mailed to _____, as agent of the Lessor, who is hereby appointed agent to receipt for the same and to receive notices given by the Lessee as provided herein. All Checks shall be mailed to the following address: _____

- 4. DRILLING NEAR DWELLING:** No wells shall be drilled, without the consent of the surface owner, within a radius of three hundred (300) feet around any dwelling house existing at the time of the drilling or within a radius of two hundred (200) feet around any other building thereon.
- 5. UNITIZATION:** Lessee shall not without the express written approval of the Lessor, have the right to pool or unitize the leased acreage, or any parts thereof, with other tracts.
- 6. SURRENDER:** Lessee may at any time, upon the payment or tender of \$_____ and all royalties, rental and damages then due under this lease, surrender all, but not part, of the land demised.

- 7. OUTSTANDING INTERESTS:** The royalties and payments herein specified are intended to be paid for a 100% ownership of the oil and gas. If Lessor owns less than 100% interest in the oil and gas, the royalty and payments shall be reduced to equal *the* interest of Lessor (i.e., if Lessor owns only a 50% interest in the oil and gas, then the royalty and payments shall automatically be reduced to 50% of the amounts herein specified).
- 8. ASSIGNMENT:** This lease shall not be assigned, hypothecated, sold or otherwise transferred to any other party without the express written consent of the Lessor, which shall not be unreasonably withheld. Provided, however, that in the event said lease is conveyed to another party, that said conveyance shall not relieve the Lessee of any duty or responsibility to the Lessor hereunder and that in the event any assignee or successor to the Lessee is not financial responsible, the Lessee shall be responsible to the Lessor for any and all sums due hereunder.
- 9. FORFEITURE:** In addition to any other grounds provided by law, the rights of Lessee hereunder shall be forfeited in full upon its failure to pay royalties upon all production and sale of minerals under this lease as and when due. This forfeiture may not be invoked by Lessor unless and until notice to Lessee is given in writing at the address shown above and Lessee fails to comply with demand from Lessor within sixty (60) days of the mailing thereof by certified mail, return receipt requested.
- 10. FORCE MAJEURE:** Should Lessee be prevented from complying with any express or implied covenant of this lease, from conducting drilling or reworking operations thereon or from producing oil or gas therefrom by operation of force majeure, or Federal or state law or any order, rule or regulation of governmental authority, not imposed because of failure of compliance or other misconduct of Lessee, then while so prevented, Lessee's obligation to comply with such covenant shall be suspended, and Lessee shall not be liable in damages for failure to comply therewith; and this lease shall be extended while and so long as Lessee is prevented by any such cause from conducting drilling or reworking operations on or from producing oil or gas from the leased premises; and the time while Lessee is so prevented shall not be counted against Lessee, anything in this lease to the contrary notwithstanding.
- 11. SHUT-IN PROVISION:** In addition to the provisions in the preceding provision, If market conditions make it economically prudent for Lessee and/or us assigns to shut-in a well, Lessee and/or its assigns may, from time to time, shut-in any well or wells drilled hereunder, and this oil and gas lease shall nonetheless continue in full force and effect; provided, however, that no such well may be shut-in under this provision for more than six months in any calendar year and, in lieu of royalty for any shut-in period, Lessee shall pay to Lessor a fee of \$_____ for each month for each such well shut-in.
- 12. BINDING EFFECT:** This lease shall be binding upon the parties hereto, their heirs, successors, and assigns.
- 13. NO STORAGE:** There shall be no storage of gas on leased tract without written permission of Lessor.
- 14. MEMORANDUM OF LEASE:** The parties hereto agree that Lessee may record a memorandum of lease executed by Lessor and Lessee.
- 15. LEGAL CONSTRUCTION:** This lease shall be construed under the laws of the State of West Virginia and the reasonable-prudent-operator rule whereby due regard is given by the Lessee to the promotion of the best mutual interests of both

Lessor and Lessee in all operational decisions hereunder.

16. SURFACE DAMAGES: (Where Lessor is surface owner.) Before drilling has commenced, but after construction of drilling sites and roadways, Lessee shall pay to Lessor, as liquidated damages, the sum of \$ _____ for each acre of surface lands disturbed during such process. This payment shall not relieve Lessee of its obligation of restoration of surface under applicable laws and regulations.

17. SPECIAL CONDITIONS: (If none, write NONE) _____

18. IN WITNESS WHEREOF THE parties have hereunto set their hands as of the day and date hereinabove written.

Signed and acknowledged in the presence of:

Lessor Signature(s):

Name: _____

By: _____

Address: _____

Name: _____

By: _____

Address: _____

Lessee Signature:

Name: _____

By: _____

Address: _____

STATE OF _____

COUNTY OF _____, to-wit

The foregoing instrument was acknowledged before me this _____ day of 20____, by

_____.

My Commission expires:

Notary Public AFFIX SIGNATURE AND SEAL HERE

STATE OF _____

COUNTY OF _____, to-wit

The foregoing instrument was acknowledged before me this _____ day of 20____, by

_____.

My Commission expires:

Notary Public AFFIX SIGNATURE AND SEAL HERE

STATE OF _____

COUNTY OF _____, to-wit

The foregoing instrument was acknowledged before me this _____ day of 20____, by

_____.

My Commission expires:

Notary Public AFFIX SIGNATURE AND SEAL HERE

SURFACE USE AND DAMAGE AGREEMENT (Sample 1)

This Agreement is made and entered into between _____, of _____, Wyoming
_____ ("Owner") and _____, of _____, _____ ("Operator").

IT IS AGREED AS FOLLOWS:

1. The Land. Operator holds interests in oil and gas leases covering the following described lands situate in Sheridan County, Wyoming:

Township _____, Range _____,
Sections _____

Sheridan County, Wyoming

and Owner owns the _____, which includes the surface of the above described lands. This Agreement covers Operator's activities on and access across the above described lands only.

2. Shallow Rights Only. Notwithstanding any other provision of this Agreement, the rights granted to Operator hereunder shall be limited to operations related to the drilling and producing of wells to the Fort Union coal formation. Surface damages for operations related to the drilling and producing of wells to greater depths shall be by a separate agreement to be negotiated by Operator and Owner.

3. Right-of-Way. Owner grants Operator, its employees and designated agents, a private right-of-way to enter upon and use the above described lands for the purpose of drilling, completing and producing oil and gas wells on Owner's land. However, access to the above described lands on Owner's portion of the private road known as the "_____" shall be by separate agreement.

4. Notification and Consultation. Operator shall notify Owner prior to entry upon Owner's land and shall consult with Owner as to the location of each well, road, pipeline, power line, pod or battery site, gathering system and other facility to be placed on Owner's land. To the maximum extent possible, Operator will use existing roads on Owner's land for its operations, and if construction of a new road is required, Operator will consult with Owner, and following such consultation locate the new road in a manner so as to cause the least interference with Owner's operations on the affected lands. If a pipeline or gathering system is to be installed by Operator, Operator will locate the pipeline and gathering system in a manner so as to cause the least interference with Owner's operations on the affected land. Operator shall notify Owner when each drilling and production operation for any well drilled on the above-described land has been completed and when Operator is permanently or temporarily absent from the surface.

5. Termination of Rights. The rights granted by Owner to Operator shall terminate when the Oil and Gas Lease terminates, Operator ceases its operations on the land, upon Operator's notification to Owner of Operator's intention to cease operations, or if Owner so elects, upon a breach of this Agreement by Operator, whichever shall occur first. Upon termination of this Agreement, Operator will execute and deliver to Owner a good and sufficient recordable release and surrender of all of Operator's rights under this Agreement, and will promptly remove all equipment and property used or placed by Operator on Owner's land unless otherwise agreed by Owner in writing.

6. Nonexclusive Rights. The rights granted by Owner to Operator are nonexclusive, and Owner reserves the right to use all access roads and all surface and subsurface uses of the land affected by this Agreement and the right to grant successive easements thereon or across on such terms and conditions as Owner deems necessary or advisable.

7. Payments. As compensation for surface damages, Operator will pay to Owner the following:

- a. Stratigraphic Test.** \$_____ per stratigraphic test (well drilled only to obtain geologic information which is not completed for production) on Owner's land. This amount shall be paid by Operator to Owner before entering upon the premises to drill.
- b. Well Locations.** \$_____ for each well location. This amount shall be paid by Operator to Owner before entering upon the premises to drill the well. Operator shall also pay to Owner an annual rental of \$_____ per year for each well site location. This annual payment shall be made on the anniversary date of the commencement of drilling of each well in each and every year until the well has been plugged and abandoned and the location of any roads and pipelines constructed in connection therewith have been reclaimed as provided herein.
- c. Roads.** Operator shall pay to Owner an initial access fee of \$_____ per rod for use of existing roads on Owner's land, and the rate of \$_____ per rod for new roads constructed by Operator or existing roads improved by Operator on Owner's land. Operator shall pay to Owner an annual access rental at the rate of \$_____ per rod for use of roads on Owner's land. The annual payment shall commence one year from the anniversary date set out in Paragraph 7.b. above for the well or wells served by such road, and shall be made on the anniversary date in each and every year thereafter until the road is reclaimed and restored by operator as provided herein. Operator shall provide Owner with a plat showing the location and length of all roads promptly after their first use, construction or improvement.
- d. Pipelines.**

 - i) For each gas gathering system pipeline and each water pipeline less than 8 inches in diameter installed by Operator, Operator shall pay to Owner the sum of \$_____ per rod for each such pipeline unless pipelines are located in the same ditch, in which case a single payment shall be made. A take up of any such pipeline shall be at the rate of \$_____ per rod. For pipelines 8 inches in diameter or larger installed by Operator, Operator shall pay to Owner the sum of \$_____ per rod for each such pipeline. A take up of any such pipeline shall be at the rate of \$_____ per rod. Payments for pipelines shall be made by Operator to Owner within fifteen (15) days after installation or take up of the pipeline. There shall be no annual rental payment.
 - ii) The pipelines referred to in this paragraph are only those gathering system pipelines used in connection with wells drilled on Owner's land or as allowed pursuant to Paragraph 8 below. Surface damages for high pressure (greater than 970 psi) gas transmission pipelines serving lands other than those owned by Owner shall be by separate agreement.
 - iii) Operator shall be responsible for backfilling, repacking, reseeding and re-contouring the surface so as not to interfere with Owner's operations. Operator shall provide Owner with a plat showing the length and location of all pipelines and gathering systems promptly after their installation. All pipelines and gathering systems located by Operator on the premises shall be buried to the depth of at least three (3) feet below the surface. Owner reserves the right to occupy, use and cultivate the lands affected by such pipelines, and to grant such rights

to others, so long as such use does not interfere with Operator's operations. If Operator fails to use any pipeline for a period in excess of 24 consecutive months, the pipeline shall be deemed abandoned and Operator shall promptly take all actions necessary or desirable to clean up, mitigate the effects of use, and render the pipeline environmentally safe and fit for abandonment in place. All such clean up and mitigation shall be performed in compliance with all federal, state and local laws and regulations.

- e. **Gathering, Metering and Compression Sites.** For each central gathering facility or "battery site" Operator shall pay to Owner an initial fee of \$_____. This amount shall be paid by Operator to Owner before entering upon the premises to construct the battery site. Operator shall also pay to Owner an annual rental of \$_____ per year for each battery site location.

f. **Power Lines.**

- i) Operator will consult with Owner and with the independent power company supplying power to Operator with respect to the location of overhead power lines prior to construction. Overhead power lines will be constructed so as to cause the least possible interference with Owner's visual landscape and Owner's existing and future ranching operations, and, to the maximum extent possible, overhead power lines will be constructed along fence lines or property lines. Construction shall not begin unless Owner has consented to the location of such power lines.
- ii) All power lines constructed by Operator downstream of the independent power company's meters shall be buried and all power line trenches shall be fully reclaimed and reseeded to the satisfaction of Owner. For buried power lines, Operator shall pay Owner a one-time payment of \$_____ per rod unless such power line is installed in the same ditch and at the same time as the pipelines described herein, in which case there will be no duplication of payment.

- g. **Increase or Decrease in Payments.** On the fifth anniversary of this Surface and Damage Agreement, and every five years thereafter, surface damage payments provided for in this paragraph shall be increased or decreased (but never below the amounts stated herein) by a percentage equal to the increase or decrease in the Consumer Price Index as published by the United States Department of Commerce for the preceding five year period.

8. **Limitation on Rights.** Owner's land may not be used in connection with operations on other lands owned by Owner which are not described herein or on other premises not owned or leased by Owner without Owner's written consent.

9. **Locations.** All well site locations shall be limited to approximately one (1) acre of land while drilling and no more than one-half (½) acre for permanent facilities. No wells shall be drilled within 1,000 feet of any residence, house or barn on the property without the prior written consent of Owner. No housing or dwelling unit shall be constructed or placed on Owner's land by Operator.

10. **Operations.** Operator shall at all times keep the well sites and the road rights-of-way safe and in good order, free of noxious weeds, litter and debris, and shall spray for noxious weeds upon reasonable demand therefor by Owner. All cattleguards and fences installed by Operator shall be kept clean and in good repair. Operator shall not permit the release or discharge of any toxic or hazardous chemicals or wastes on Owner's land.

Operator shall remove only the minimum amount of vegetation necessary for the construction of roads and facilities. Topsoil shall be conserved during excavation and reused as cover on disturbed areas to facilitate regrowth of vegetation. No construction or routine maintenance activities will be performed during periods when the soil is too wet to adequately support construction equipment. If such equipment creates ruts in excess of two inches deep, the soil shall be deemed too wet to adequately support construction equipment. All culverts shall be at least 18 inches in diameter. All surface facilities not subject to safety requirements shall be painted to blend with the natural color of the landscape. Only truck mounted drilling rigs will be allowed to drill on the property, and no seismic operations shall be permitted without Owner's written consent.

11. Consolidation of Facilities. Whenever possible, Operator will consolidate its facilities for as many wells as practical. Incoming power will be located at centralized points to minimize to the maximum extent possible the construction of above ground power lines. Battery sites will serve as many wells as possible. The consolidated facilities may not be used for operations connected with lands not owned by Owner or with lands owned or leased by Owner which are not described herein.

12. Dry Hole. If Operator does not discover oil and gas in paying quantities at a well site and determines the well to be a "dry hole" or upon cessation of production, Operator will give Owner thirty (30) days written notice of the opportunity to take over any abandoned well and convert the well to a water well. If Owner elects in writing to take over the abandoned well and convert the well to a water well, then the Owner will assume all liability and costs associated with the well thereafter, and both parties shall execute any and all documents necessary to provide that the water in the well shall become the property and responsibility of the Owner. If Owner does not elect to take over the well and convert it to a water well, then Operator shall fill and level the location, re-contour the location, distribute the top soil, make the location ready for reseeding and reseed the area, and plug and abandon the well as required by applicable law and regulations. All cleanup and restoration requirements shall be completed, if weather permits, by Operator within six (6) months after termination of drilling or production activities at the well site.

13. New Roads. Any new roads constructed by or for Operator shall be limited to twenty (20) feet in width for the actually traveled roadbed, together with a reasonable width, not to exceed fifteen (15) feet from the edge of the actually traveled roadbed for fills, shoulders and crosses. No permanent roads will be constructed unless absolutely necessary and Owner consents to the construction and location of the road. Operator shall annually maintain existing and newly constructed roads used by Operator to the satisfaction of Owner, which maintenance may include shaling, ditching, graveling, blading, installing and cleaning culverts, and spraying for noxious weeds.

14. Fences. Operator shall construct stock-tight fences around any dangerous area, including any pits where Operator drills wells. Operator shall rehabilitate and restore all disturbed areas caused by Operator's operations within six (6) months after termination of drilling or production activities at the well site and right-of-way, unless inclement weather prevents such rehabilitation and restoration within that time period.

15. Cattleguards. Operator shall construct cattleguards with wings at all fence crossings designated by Owner. Installation of the cattleguards shall be at the sole cost and expense of Operator. Cattleguards shall not be less than 16 feet wide by 8 feet across and shall be set on concrete sills not less than 24 inches high by 16 inches wide. Fence braces shall be installed on each side of the cattleguards. Fence braces shall be constructed of like quality material and installed in like style and form as the fence braces currently constructed on Owner's lands. Cattleguards shall be constructed approximately 6 inches above the existing grade of the road so that water does not run into the cattleguard. Operator shall be responsible for maintenance of all cattleguards used by Operator, together with wings and attached braces. All cattleguards currently in existence on roads used by Operator which are not aligned with existing fence lines shall be reconstructed by Operator so as to be in line with the fence.

16. Improvements. No fences, cattleguards or other improvements on Owner's property shall be cut or damaged by Operator without the prior written consent of Owner and the payment of additional damages or the institution of other safeguards to protect the rights and property of the Owner. Upon final termination of Operator's rights under this Agreement, Operator shall return all roads and other rights-of-way or sites as near as practical to the condition which they were in prior to the execution of this Agreement, unless otherwise agreed by Owner. Unless otherwise agreed by Owner, all disturbed areas caused by Operator's activities will be reseeded. Cattleguards shall be removed and fences restored as near as practical to the original condition unless otherwise agreed by Owner,

in which case all cattleguards installed by Operator shall become the property of Owner. All cattleguards and fences installed by Operator shall be kept clean and in good repair.

17. Fencing of Access Roads. Operator will not fence any access roads without the prior consent of Owner.

18. Purchase of Shale and Water. To the extent that Operator's activities require the use of shale, gravel, or water, where reasonable and practicable Operator shall purchase shale, gravel, or water from Owner at the rates prevailing in the area. Operator recognizes Owner's concern about importation of noxious weeds onto Owner's land and, therefore, agrees wherever possible to purchase shale, gravel, or water from Owner.

19. First Preference for Work. Operator shall give first preference to Owner in awarding contracts for any work required to be performed on Owner's land pursuant to the terms of this Agreement, including but not limited to earthmoving, grading or plowing roads, spraying noxious weeds, or reseeding, provided that Owner has the equipment necessary to accomplish the work, is capable of adequately performing the work and is willing to perform the work at rates prevailing in the area.

20. Payments. The payments herein provided are acknowledged by Owner as sufficient and in full satisfaction for damages to Owner caused or created by the reasonable and customary entry, rights-of-way and operation and use of the roads and well sites, but do not include damage to livestock, buildings or improvements, or injuries to persons or to any damage or destruction caused to Owner's wells or water supply on the property. Operator shall be liable for damages if, as a result of its operations hereunder, any water on or under the premises which had been potable is affected to the extent that it is rendered nonpotable for humans, cattle or other ranch animals on Owner's premises, or any such water supply, well or reservoir be destroyed or its output diminished. Operator shall be liable for any downstream damage caused to other lands or the operations of other landowners. This Agreement does not relieve Operator from liability due to Operator's negligence or due to spills or discharges of any hydrocarbon or toxic or hazardous chemicals or wastes, or from leaks or breaks in Operator's pipelines. Damage to livestock and damage to crops shall be paid for by Operator at current market value. Any fires caused by Operator's personnel, agents, or assigns shall be paid for by paying the cost of replacement pasture, the costs of trailing or trucking cattle to replacement pasture plus replacement and/or repair costs for all personal property destroyed or damaged. The cost of replacement pasture will be determined by the amount generally accepted in the area for like kind pasture.

21. Restoration. Unless Owner otherwise agrees in writing, upon termination of any of Operator's operations on Owner's land, Operator shall fully restore and level the surface of the land affected by such terminated operations as near as possible to the contours which existed prior to such operations. Operator shall use water bars and such other measures as appropriate to prevent erosion and nonsource pollution. Operator shall fully restore all private roads and drainage and irrigation ditches disturbed by Operator's operations as near as possible to the condition which existed prior to such operations. All surface restoration shall be accomplished to the satisfaction of Owner.

22. Reseeding. All reseeding shall be done with suitable grasses selected by Owner and during a planting period selected by Owner. Reseeding shall be done at the rate of twelve (12) pounds of seed per acre for range land, and an amount to be determined by Owner for irrigated ground. In the absence of direction from Owner, no reseeding (except for borrow pits) will be required on any existing access roads. It shall be the duty of Operator to insure that a growing ground cover is established upon the disturbed soils and Operator shall reseed as necessary to accomplish that duty. It shall further be the duty of Operator to inspect and control all noxious weeds as may become established within areas used or disturbed by Operator. Operator shall inspect disturbed areas at such times as Owner shall reasonably request in order to determine the growth of ground cover and/or noxious weeds, and Operator shall reseed ground cover and control noxious weeds from time to time to the extent necessary to accomplish its obligations hereunder. Operator recognizes that this shall be a continuing obligation and Operator shall reseed ground cover and/or control noxious weeds until areas disturbed by Operator are returned to as good condition as existed prior to construction.

23. No Warranty. Owner makes no warranty of title or otherwise in entering into this Agreement.

24. Nondisturbance. Operator and its employees and authorized agents shall not disturb, use or travel upon any of the land of Owner not subject to this Agreement.

25. Firearms and Explosives. None of Operator's employees or authorized agents or any other person under the direction or control of Operator shall be permitted to carry firearms or any weapon while crossing Owner's property, and such persons shall not hunt or fish on Owner's property and shall not trespass on Owner's property for the purposes of hunting or fishing or recreational uses. No dogs will be permitted on Owner's property at any time. No explosives shall be used on Owner's property. Operator will notify all of its contractors, agents and employees that no dogs, firearms, weapons, hunting, fishing or recreational activities will be allowed on Owner's property.

26. Surface Owner's Water. Operator shall not disturb, interfere with, fill, or block any creek, reservoir, spring, or other source of water on Owner's land. Before conducting any drilling operations, Operator, at its sole cost and expense, will measure or cause to be measured the static water level and productive capacity of all water wells and springs located on Owner's land within one mile of Operator's wells, and will test the water wells for the presence of methane. Operator shall also provide Owner a chemical analysis of all wells and springs within one mile of Operator's wells, which analysis shall measure, at a minimum, the following:

- pH
- Hardness (ppm and grains/gallon)
- Conductivity (mmhos/cm)
- Sodium Absorption Ratio
- Adjusted Sodium Absorption Ratio
- Cation/Anion Ratio
- PPM of Calcium, Magnesium, Potassium, Sodium, Iron
- Total Alkalinity (CaCO₃)
- Carbonate
- Bicarbonate
- Hydroxide
- Chloride
- Sulfur as SO₄
- Salt Concentration (TDS)
- Boron
- Nitrate
- Nitrite
- Ammonia Nitrogen
- Phosphorus
- Methane

Owner shall be notified prior to such testing and measuring and Owner or its agents or representatives shall have the right to be present during such testing and measuring. The results of these tests and measurements will be immediately provided to Owner. Operator shall establish a continuing water well monitoring program to identify changes in the capacity of any water wells located on Owner's land and in the methane content of the wells, and Operator shall immediately provide that monitoring data to Owner.

27. Loss or Impairment of Water Wells or Springs. In the event that any water well or spring located on Owner's land is lost or materially diminished in productivity, or the quality of water produced by such well or spring is reduced so that the water is unusable by livestock or humans (as the case may be), as a result of production of oil, gas, or water by Operator, Operator shall, at its expense, immediately repair or replace any water well or spring which is lost or diminished in productivity with a new water well or spring at least equal in productivity and quality of water to the lost or diminished well or spring, using a water well drilling contractor acceptable to Owner.

28. Produced Water. Surface discharge of produced water will be allowed on Owner's land only with Owner's prior written consent, and only after Owner has approved, in writing, Operator's written water

management plan for each discharge point located on Owner's land. In any event, such discharge will be permitted only if it does not degrade or adversely affect the quality of water in reservoirs and water courses on Owner's land or otherwise damage Owner's land. If Owner does not consent to surface discharge of produced water, Operator shall be responsible for piping water off Owner's land and making appropriate arrangements for discharge with adjacent landowners. All water produced and discharged from Operator's wells shall be produced and discharged in accordance with all applicable rules and regulations of any governmental authority. Whenever possible, and if Owner so consents, the produced water shall be discharged directly into an existing drainage system or reservoir, if allowed by applicable laws and regulations, and if the discharge will not degrade or adversely affect the quality of water in the drainage system or reservoir, so that the Owner may make beneficial use of the water. Produced water shall be discharged in a way so as to cause the least amount of surface disturbance and damage to Owner's land.

29. Reservoirs. If Owner consents to the discharge of produced water but does not wish Operator to discharge any of its produced water into Owner's existing reservoirs, Operator shall be solely responsible for finding a suitable water discharge location acceptable to Owner, building the necessary catchment structures (including pipelines, dikes, dams, and outlet piping) and maintaining the same at its sole cost, risk and expense. Similarly, if Operator requests and is granted permission to use any of Owner's reservoirs, should any such reservoirs require modification, upgrading and/or improvement to be able to hold Operator's produced water, any such modification, upgrading or improvement shall be done at Operator's sole cost, risk and expense. Owner shall not be responsible for payment of any cost associated with Operator's development activities which shall include, but not be limited to water discharge, catchment of produced water or maintenance of any related facilities.

30. Water Well Mitigation Agreement. Operator is aware that its operations may impact domestic and/or agricultural water wells in the vicinity of coal bed methane producing wells. In order that the parties hereto may avoid potential future conflict regarding loss of use or degradation of existing water wells by Owner, Owner and Operator hereby adopt the terms and conditions of the Water Well Mitigation Agreement attached hereto as Exhibit "A," to the extent that the terms of Exhibit "A" are not inconsistent with the terms of this Agreement.

31. Enforcement Costs. If Operator defaults under this Agreement, Operator shall pay all costs and expenses, including a reasonable attorney's fee, incurred by Owner in enforcing this Agreement.

32. Time. Time is of the essence in this Agreement.

33. Indemnification. To the maximum extent permitted by law, Operator will indemnify, defend and hold Owner, and if applicable, Owner's officers, directors, employees, agents, successors and assigns harmless from any and all claims, liabilities, demands, suits, losses, damages and costs (including, without limitation, any attorney fees) which may arise out of or be related to Operator's activities on Owner's property (including, without limitation, any claims that Operator's operations hereunder are either illegal, unauthorized, or constitute an improper interference with any parties' rights, or have damaged the lands or operations of adjacent landowners, and including any claims based on the alleged concurrent negligence of Owner).

34. Compliance with Law. Operator shall conduct operations and activities in accordance with existing local, state and federal laws, rules and regulations.

35. Release. To the maximum extent permitted by law, Operator releases and waives and discharges Owner, and, if applicable, Owner's officers, directors, employees, agents, successors and assigns from any and all liabilities for personal injury, death, property damage or otherwise arising out of Operator's operations under this Agreement or use of Owner's property.

36. Notice. Notice may be given to either party to this Agreement by depositing the same in the United States mail postage prepaid, duly addressed to the other party at the address set out below the party's signature on this Agreement. Such notice shall be deemed delivered when deposited in the United States mail.

37. Designated Contact Person. Operator and Owner will each from time to time designate an individual, with appropriate twenty-four hour telephone and fax numbers, who is to be the primary contact person for discussions and decisions concerning matters related to this Agreement.

38. Recording. This Agreement may not be recorded without the written consent of Owner.

39. Construction of Agreement. This Agreement shall be construed under the laws of the State of Wyoming.

40. Nonassignability. This Agreement shall not be assigned by Operator to any other entity either in whole or in part, unless Owner consents in writing to such assignment.

41. Binding Effect. This Agreement is binding upon the successors and assigns of the parties.

DATED this _____ day of _____, 1999.

OWNER

By: _____

Title: _____

Address: _____
_____, _____

OPERATOR

By: _____

Title: _____

Address: _____
