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The "Standard Producers 88 Oil and Gas Lease in America"

Land Owner's Guide, Appraisers' and Lenders' Consideration of the American "Standard Producers 88 Oil and Gas Lease" in Regards to the Title and Surface Owner's Estate

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John S. Baen, Ph.D.
Professor of Real Estate
College of Business Administration
University of North Texas
PO BOX 305339
Denton, TX 76203-5339
Tel: (940) 507-0312
Fax: (940) 565-3803
Email: baen@unt.edu
www.cob.unt.edu/firel/Baen

Abstract

Land Owner's Guide, Appraisers' and Lenders' Consideration of the American "Standard Producers 88 Oil and Gas Lease" in Regards to the Title and Surface Owner's Estate

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There is a widespread drilling boom occurring in Pennsylvania, Ohio, New York, North Dakota, Florida, Texas and many other states due to new technologies allowing economic production from deep shale. There is currently exploration in "new" areas where average people owning mineral rights and their professionals have little knowledge or experience in oil and gas leases, their negotiation or oil and gas law. The abstracting and research of the most prevalent lease form in America, the "Standard Producers 88 Oil and Gas Lease" is the topic of this paper because it signed by private and public land/ mineral owners without regard for full consideration of the potential economic impact to the surface estate based on the rights and options transferred at the time the "paid up" lease is signed. These rights and options over both the surface and subsurface mineral estate have serious implications for appraisers, lenders, and the mineral owners/ lessees. A timeline is presented of the "typical" new oil exploration area which primarily has the "Standard Producers 88 Oil and Gas Lease" use in the early phases of areas of interest by the oil companies. Key words: Bonus money, royalty, drill-sites, surface damages, disposal, injection wells.

Introduction

The "Standard Producers 88 Oil, Gas, and Mineral Lease," also known as the "printed form," is the most widely used access and granting document in use by the Oil and Gas exploration industry in America. The industry is driven by a given area of interest based on geological prospects followed by leases being signed by individual subsurface mineral owners who may or may not own the surface estate. Exciting new areas of exploration are occurring in Ohio, New York, North Dakota, South Dakota, Florida, and elsewhere based on the new geotechnical, dealing in drilling, and "frac" technologies. The newer the area the less sophisticated are the local population in oil and gas leases.

The moment an Oil and Gas Lease is signed and filed of Public Record, the transfer of options and rights over, under, and on the surface estate has important implications to the surface owners, appraisers, and mortgage companies/ lenders for the life of the lease and/or production if petroleum is found in "paying quantities." The broad and exclusive options to use the surface is transferred to the oil and gas company for the primary term (3-5 years) of the lease as well as the long-term extended period of "economic" oil and gas production.

There are five (5) major perspectives this paper presents:

- 1) Sample "Standard Producers 88 Oil and Gas Lease" (Figure I)
- 2) New oil and gas exploration areas in the US (Figures II and III)
- 3) An abstract overview of the rights and options transferred upon signing a "Standard Producers 88 Oil and Gas Lease" (Figure I)
- 4) A generalized timeline of a typical leasing and oil and gas exploration/ production cycle
- 5) Typical questions land/mineral owners have asked in regard to their leasing
- 6) Perspectives of potential surface use/subsurface use conflicts and generalized suggestions to consider in any oil and gas lease document.

Many surface owners do not have mineral rights in historically producing areas. Often time previous land owners/sellers retained all or part of their mineral rights by either retaining them in a granting deed when selling the surface estate or prior to selling the surface in a separate mineral/ oil and gas deed to a family trust, Family Limited Partnership (FLP) or perhaps sold to a buyer of mineral and/or royalty rights.

The closer oil and gas production occurs to any given property, the more likely minerals were retained over time and become a major negotiation factor when land is purchased, sold, or divided between various heirs by will. However, there are many parts of the U.S. which until recently, have never had significant or economic oil and gas leasing or activities, and therefore the surface and subsurface estate remain intact and remain in one ownership.

See Figure II and III- US Map of New Shale Field Discoveries

These totally new areas of "virgin" oil and gas activities and leasing are met with a general lack of understanding, education, and experience in the seriousness and potential impacts of the "Standard Producers 88 Oil and Gas Lease." This lack of understanding is met with both

disbelief and excitement that a company would actually pay thousands of dollars in bonus money¹ per acre for the option to possibly drill their minerals.

Where to turn for professional advice and legal representation is often a serious problem as often times local attorneys have little to no oil and gas experience or recent coursework from their law school education. Most often a local attorney will break out the Oil and Gas Law Reference Books and "brush up" on the basic law and in good faith attempt to render their clients some professional assistance.

The problem is many mineral owners when receiving an Oil and Gas Lease in the mail, seek no professional advice (or expertise) and quite often simply sign and notarize the document, cash the bonus check (or draft²) and return the executed lease by mail without having any idea of the complexity and rights to their surface and subsurface estate that they have transferred. The excitement and prospects of an oil and gas well possibly changing their financial well-being and lives, quite often takes the place of sound legal and vice and disregard for economic implications of the document. If a well is never drilled and the lease expires, which happens often, then no harm was done and no lessons learned.

This paper's focus is to offer helpful insights and perspectives in regard to the importance of understanding the granting clauses found in most oil and gas leases and the implication of those lease provision on the surface estate and mineral estate. While most major oil companies are reasonable stewards of the land and work with surface owners prior to construction, the "Standard 88 Oil and Gas Lease" gives them the option, the right, to control and construct almost anything on the surface that is remotely related to the exploration, production, compression, and transportation of oil, gas, and other minerals so long as oil and gas continues in "paying quantities."

¹ Note: Bonus Money. Upfront signing bonus money can vary from \$100/acre in early stages of an oil and gas play to 1,000's of dollars after a commercial/ economics well is drilled.

² Note: A Draft is a "30 day sight draft" is used instead of a check, in order to allow a final title examination before cashed.

Literature Review – “Standard Producers 88 Oil and Gas Lease”

There have been many topics and/or references and articles written on the topic which are found in Oil and Gas Industry publications such as: *The Oil and Gas Journal*, *The Oil and Gas Investor and the Landman- American Association of Professional Landmen (ISSN 0457-088X)*. These references are primarily from the industry perspective and not written for the general public or for those who are signing oil and gas leases.

The other body of literature and references comes from various law journals and related oil and gas law books/ texts which relate to legal interpretations and case law in regards to petroleum leases, various specific clauses and/or interpretation and disputes. These references are of little use to the general public who voluntarily sign “Standard Producers 88 Oil and Gas Leases.”

Consideration of oil and gas mineral rights in land appraisals (Baen, 1988), and the impact of mineral rights and oil and gas activities on agricultural land values (Baen, 1996) were published in the *Appraisal Journal* and refer to various leases, and surface activities as they relate to surface value implications after wells have been drilled. Other research papers discussed and suggested ways to reduce surface impacts of drilling (Baen, 2004, 2005).

Most surface/ mineral owners, appraisers and lenders only realize the rights that were transferred after the “Standard Producers 88 Oil and Gas Lease” is signed when they have a reason to request a title policy (sale or transfer) or mortgage’s title policy (lending purposes) or when an oil and gas exploration commence on the surface estate, or a title policy.

Oil and gas laws vary widely by state as to the extent the oil company may utilize the surface estate. Texas has a “reasonable surface use” legal interpretation which dictates that oil and gas companies should not waste or cause waste of the surface estate which is subordinate to the mineral estate. Defining reasonable in a very hard to quantify except through litigation in terms of:

- a) Access roads/ location, size, width, specifications, etc. etc.
- b) Drilling location/ drill-site size (1-10 acres)
- c) Location of pipelines, flow lines, power lines, etc.
- d) Size of compressors (noise, etc)
- e) Reasonable use of water
- f) Etc.

A “Standard Producers 88 Oil and Gas Lease” is both specific and broad as to the transfer of rights, options, and use of the surface estate. The only way to avoid disputes over “what is reasonable” is to specifically define these terms in the initial lease addenda to the “Standard Producers 88 Oil and Gas Lease” or the litigate. For lands located within city limits there are some cities (Fort Worth, Houston, and Los Angeles) that have drilling ordinances that can “protect” surface estate where municipal drilling permits are required. Only the most sophisticated of leases had “addendums” that specifically define all the surface use understanding which can also include land plans, specific drill-site and production site drawings.

Overview of the “Standard Producers 88 Oil and Gas Lease” and the Option Rights Transferred at the Time of Acceptance by all Parties

Firstly, there is no such thing as a “Standard Producers 88 Oil and Gas Lease” printed form except in the eyes and mind of the general public in new oil and gas exploration areas.

While the “Standard Producers 88 Oil and Gas Lease” printed form historically has been and continues to be the predominate oil and gas lease in America, there are countless variations made by various companies. In other words while there are similarities in all “Standard Producers 88 Oil and Gas Leases,” there are also wide ranging variations which are generally in favor of the oil company offering to lease minerals.

The frustrating part of this research was the difficulty in finding an “original” version the industry has utilized prior to customize changes being made. After carefully reviewing over 35 printed form “Standard Producers 88 Oil and Gas Leases,” it was determined that the “Producers 88 (7-1969) Paid Up, with 640 Acre Pooling Provision” was the purest form available for this research (see Figure III).

See Figure I – “Standard Producers 88 Oil and Gas Lease” (Producers 88 (7-69) Paid Up-with 640 Acre Pooling Provision)

Figure IV- An Overview of Various Rights and Options Transferred at the Time a “Standard Producers 88 Oil and Gas Lease” is Signed

Figure V- TYPICAL TIME TABLE AND PLAYERS OF “STANDARD PRODUCERS 88 OIL AND GAS LEASE” Activity in Virgin Areas of Exploration

Figure VI- “Standard Producers 88 Oil and Gas Lease” Provisions and Lessee Recommendations for Addendum Language to any Lease

Is the "Standard Producers 88 Oil and Gas Lease" Ethical and Honest?

This is nothing illegal, unethical or dishonest about the "Standard Producers 88 Oil and Gas Lease" which is a variation the historic and contemporary "workhorse" of the oil and gas leasing and exploration industry. It is generally met with joy by the majority of people who sign them for any or all of the following reasons:

- 1) Up front signing bonus money is considered pennies from heaven that often total tens of thousands of dollars
- 2) The eternal human hope that if the lessee drills a fabulously successful well, that all their financial dreams will come true
- 3) The simultaneous negative attitude that up front bonus money is all I am likely to ever get and I have never received a lease offer before... I better take it now! (Don't believe until they actually see well drilled "syndrome.")
- 4) I cannot believe something good can happen to me; this lease offer is pennies from heaven or a "lotto" occurrence.

Professional landmen and lease negotiators are hired by oil companies to get "Standard Producers 88 Oil and Gas Leases" signed (or some variation). They are generally a positive, outgoing, friendly group who work by the day for \$150-550/day. They are trained professional closers and are often members of various professional organizations.

After many mineral owners have signed leases they "hear" others got more and they were "taken" by not getting more bonus money, more royalties or whatever. The longer an oil boom last, the more lucrative the leases become... until the oil boom "busts". Landmen are often blamed for being sharks, crooks and worse. However, they have codes of ethics, however, but are not required to educate or suggest various provisions of leases be added stricken or altered. Remember they work for those who hired them, the oil companies.

In new exploration boom areas of Oil and Gas activities, quite often there are not only oil and gas companies collecting leases, but also wholesalers, speculators and middlemen lease consolidators whose only objective is to "turn" or resell the leases at a profit on a per acre basis or percentage of the potential well (overrides). While there is nothing illegal or inherently wrong with this, it is quite correct to assume that there are "agency" issues as to who represents whom during lease negotiations. Those presenting an offer to lease generally represent and are paid directly or indirectly to represent the oil companies best interest no matter how friendly and courteous the landmen are to the Lessor. Almost everyone represents directly or indirectly the Oil and Gas Companies and unbiased professional advice is difficult to obtain. It is my opinion that 99% of all professional "landmen" represent the oil companies and are basically hired to obtain signed leases with as few changes as possible.

When is the Power of the "88" Discovered by Mineral/Owner

The occasion to review the title and the dominate rights and option power of an oil and gas lease over the surface estate is generally not fully realized and is triggered or discovered by any of the following:

- 1) Refinancing the land and/or improvements (mortgages or lenders title policy)
- 2) Building a new improvement on the land (mortgages' lenders title policy)
- 3) Sale of part of the surface estate to a third party who does not want a "cloud on the title" or only limited surface use control. (Title Insurance Policy)
- 4) Prior to the first payment of royalty to the "mineral owner" for first production checks from oil and gas well. (If a loan or mortgage was in place prior to the oil and gas lease, a release of lien or subordination agreement from lenders is often required or royalty payments are:
 - a. Retained in a suspense account by the oil company or "first" purchaser, pipeline or oil purchasing company or
 - b. Royalty payments and paid to the lender/mortgage company to protect the oil and gas lease or lessee (priority of liens)

Example of Educated Property Owner's Oil Lease Questions and Thoughts

Interest in Delinquent Royalties

- How do I protect the ranch if Lessee does not pay? Shall Lessor retain a lien and security interests in all rights of Lessee if Lessee does not pay? How do we secure payments of royalty? What if Lessee goes bankrupt or sells to others?
- If there is litigation between Lessee and Lessor, do we go to court, arbitration, what?
- If partners leasing the Ranch split ways do I need to chase down each partner for payment or can we do it a simpler way?
- Why payment in 120 days instead of 90 or 60?
- Why 12% interest and not 5% above WSJ corporate loans (which is higher?)
- Why not a termination of contract after a period of time?
- Do we want to include or exclude possibilities of third party payment? (So-and-so pays on behalf of the oil company?)

Total Cessation of Production – Automatic Termination

- Does the operation need to be continuous? If Lessee starts a well and disappears and comes back for two days every 90 days it can drag forever.
- If well is abandoned, what happens? Would be OK to agree on a term of 6 months for Lessee to clean and take all equipment out? If they do not do that, may Lessor removes all equipment and Lessee pays for it?
- If well or lease are abandoned Lessee must:
 - Plug the well in compliance with law?
 - Protect all fresh water in all zones (surface and groundwater), whatever it takes?
 - Clean the well location and surface?
 - Remove all junk, pipes, plastic, steel material, dangerous materials, and anything that can cause damage, injury or death to land, people, livestock, and wildlife?
 - Avoid top and subsoil contamination and erosion. Clean all contamination of top, subsoil, and water?

Drilling Operation Defined

- Is this strong enough language? Again, what if a rig comes to place, workers work for two days and disappear for a month, etc.?

23 Pugh Horizontal and Vertical

- Do we need to establish a minimum distance from the houses, barns, big lake working pens because of noise or other possible problems?

Drill Site and Surface Restrictions

- Do we need to establish a minimum distance from the houses, barns, big lake working pens because of noise or other possible problems as well as animal pens exclusion (also for view from the house)?
- Can this restriction be weaved with common agreement if wells are productive?

Damages/ Cleanup / Advance Damages

- Advance damages: \$3,000
- Salt water, sulfur water, other water spills, and spills on top and subsoil must be prevented and cleaned at law specification or beyond
- If well site is within animal pen high fences, fence must be 8' tall
- Tree may not be cut or damaged especially oaks of any age; if necessary (Lessor and Lessee can discuss if added to lease with absolute mutual agreement provision) trees can be cut/ trimmed upon written agreement and agreed fees for damaged or cut tree (or buy a new tree and replant it- with warranty from seller- somewhere else). Disturbing trees must be kept at a minimum (except for mesquites and cedar).

Litigation and Liability and Insurance

- Lessee is liable for all its equipment, men, alleged or real injuries, deaths, and damages caused to ranch or to third parties. Lessee indemnifies and holds harmless the surface owner and all employees and pays reasonable attorney fees and expenses (unless surface owners and employees have gross negligence or are in bad faith)
- Must Lessee keep a minimum of insurance per person per event?
- What if there is an explosion on ranch during a "2011-like" drought and winds and fire like in Bastrop on Labor Day? And neighbors are destroyed?
- In case there is a litigation of third parties or government against Lessee, will Lessor be notified and defended and/or paid reasonable attorney fees and expenses? If Ranch/Lessor is damaged as well, should it be included in the settlement?
- If EPA sues Lessee and wins for water or ground pollution, and maybe comes after me as well...what happens to my ranch and me?

Miscellaneous

- Will roads be kept in good conditions? Will material used to build new roads or repaired old ones be kept under control to avoid dust in livestock feed, barns, ranch equipment, etc.?
- Must roads be maintained and holes fixed, especially in wet weather, avoiding mud messes?
- If dirt is moved into location for construction or repair from outside the ranch, will dirt be treated for noxious weeds and possible diseases or fever ticks? We want to avoid an invasion of grass spurs or fever ticks, FMD, etc.
- Can we ask that dirt be dug on ranch, so while digging we dig a new pond as well, and possibly make money on sale of material to oil recovery?
- If soil is removed from within the ranch, can we ask them to keep top and sub soil in two piles so that when they restore it we have better chance of good grass? (need to ask if it makes a difference in replanting)
- Restoration: if well and/or lease are abandoned, restoration must be complete: clean from any trash, material etc; clean from hazardous material or spills, restoration of soil (sub and top), disking, planting grass, jigs, or preferably, and repair holes or land depressions as it was. If agreed by Lessee, Lessor can be hired by Lessee and will perform the disking, and planning of grass, etc.

- Can Lessee equipment to be painted according to Lessor's choice of color?
- Will maximum sound reduction be used in order not disturb the enjoyment of the ranch by Lessor and fishermen of fishing club
- What about land erosion caused by Lessee's equipment? Or pipelines?
- How will possible fines be imposed if Lessee keeps violating agreement and is disrespectful of ranch operations (it breaks agreement 4-5 or more times on similar circumstances) \$1,000 per violation? (In other words, how do the Oil Company and/or ranch enforce our agreement with oil workers and drivers?)
- What about possible fines if at termination of well or lease Lessee or successor of lessee does not clean up and disappears (\$\$\$/day)?
- Pipelines (especially if they cross the ranch)
 - Must be buried so we can plow and do other agriculture activities without danger of breaking them?
 - Must they be marked visibly? Would this provision need to be enforced with fees for failing to do so (like \$3/ft)?
 - Should they be maintained weed and brush free so that spills are visible right away?
 - Should Lessee restore landscape once pipelines are removed?
- Will construction material be cleaned out of tank spillways and creek?
- Will equipment moving dirt or with track should be power-washed and cleaned for diseases or noxious weeds? Special precaution may be established at a later date in case TAHC declares the outburst of a disease like Foot and Mouth. If equipment comes from South Texas, will special precautions be taken? If equipment is not from South Texas, can written notice be given as a guarantee?
- Will there be a solar automatic gate at perimeter fences?
- Can Lessee designate one or more parcel of land for development 200/300 acres or possibility to do it later on?
- Is it possible to decide together, without compromising ability of Lessee for a producing well, where to drill (include surface owner in the process)?"?
- Where will portable bathrooms be placed for Lessee's workers? (No using nature.)

Water

- Can Lessee use tank or well water with consent of Lessor and for a price (we can sell water from our well and tank, and if so, for how much?)
- When lessee drills a well of its own, what about charging for the water since it is privately owned by law and state constitution, but Lessee enjoys it? And if so, how much?
- Why not keep some of the wiring, pump, meters, etc. of the well once Lessee is gone? Could lessee give an option to buy them?
- Should Lessee pay all the expense in capturing water, including but not limited to electricity, repairs, replace pump if it breaks?

No Hunting/Firearms

- No fishing nor sporting paraphernalia
- Neither photos nor video of animals, ranch operation, livestock working, etc.

- No video or cameras unless for Lessee's operations
- No Facebook/social networking photos or gossip involving ranch operation
- No recreation bathing
- Lessor may inspect all of the above
- No taking of artifacts, plants, antlers, rocks, etc.
- No hunt, trap, fish, dog, gun, alcohol, illegal drug
- No trashing with papers, boxes, hazardous trash, etc.
- No wondering around or trespassing in area where Lessee is not working
- No soil erosion
- No polluting of the soil or waters
- No damaging crops, grasses, trees, habitat
- No harming or injuring wildlife, animals, livestock, owners' or employee's dogs
- No interfering on recreational use of ranch by owner and guest fisherman (if possible)
- No waste oil or water on premises
- No bulldozing work, cut trees and senderos, construct power lines, tanks, building structures, etc. if not already in the agreement or, if new, negotiated and agreed upon by parties (if Lessee changes plans, we can be flexible if Lessor is notified and agrees with Lessee)
- What about smoking tobacco, other substances, or using fire?
- What about the Lessee to establish privately owned electric lines, fiber optic lines, mobile buildings, etc?

Objectionable Employees

- If a Lessee's employee, agent, representative, contractors become objectionable (are rude, disrespectful, drive like crazy, almost bump into livestock or run over dogs, leave gates open, etc.) Lessor can give written notice with reasons of what happened to Lessee and if Lessee does not remove such persons voluntarily within 10-15 days, can Lessor forbid entrance of the objectionable person? Again, how do we keep unruly workers inline?

Remedies: \$1,000 for each violation of agreement after 4 violations

No Fly Zone: Do we establish a no fly and landing zone, unless requested?

Conclusion

The general public and many professionals are not aware of the powerful and long-term option rights and transfer of rights that occur when a "Standard Producers 88 Oil and Gas Lease" is signed. The rights, options granted and control of the surface and subsurface estate last no less than the primary term of the lease. If a well is drilled those rights and options for surface remain and continue in effect so long as oil and gas is produced in "paying quantities"... This can be for a period of 30-40 years or the economic life of any well on the lease and even perpetually if well is "shut in" or capped without limitations.

These Lessee rights and unlimited options to the land can interfere long term with the future highest and best use, financing, or development of the land. The title exception of a "Standard Producing 88 Oil and Gas Lease," which has been filed of record poses very real questions that should be considered by owners, appraisers, and lenders as really "clouds" on the title or future users of land until the leases expire or are abandoned and released in the public record. Lessors should consider all aspects of future development of raw land and should carefully consider well locations, and access roads, pipelines, and electricity lines as reflected in well thought out addenda provisions.

Oil and gas wells can be planned and operated so as not to unduly conflict with existing or future land uses, even in highly concentrated urban areas. With proper planning and inclusion of various lease provisions, negative impacts to the land can be reduced. However, important lease provisions and addenda need to be initiated, and included considered in order to maximized the full potential of the surface estates highest and best use while maximizing the rate of return on mineral value. After a "Standard Producers 88 Oil and Gas Lease" is signed and accepted is no time to consider these concepts and suggestions presented in this research.

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Figure I – "Standard Producers 88 Oil and Gas Lease" (Producers 88 (7-69) Paid Up- with 640 Acre Pooling Provision)

An overview of the transfer of various rights and options to the Lessee are found.
John S. Baen, Ph.D. University of North Texas, College of Business, baen@unt.edu, www.cob.unt.edu/firel/baen

Producers 88 (7-69) Paid Up
With 640 Acre Pooling Provision

OIL, GAS AND MINERAL LEASE

THIS AGREEMENT made this DATE, between LESSOR, Lessor (whether one or more), whose address is: ADDRESS, and LESSEE, Lessee, WITNESSETH:

1. Lessor in consideration of Ten and no/100 and other good and valuable consideration Dollars (\$10.00 & OVC), receipt of which is hereby acknowledged, and of the covenants and agreements of Lessee hereinafter contained, does hereby grant, lease and let unto Lessee the land covered hereby for the purposes and with the exclusive right of exploring, drilling, mining and operating for, producing and owning oil, gas, sulphur and all other minerals (whether or not similar to those mentioned), together with the right to make surveys on said land, lay pipe lines, establish and utilize facilities for surface or subsurface disposal of salt water, construct roads and bridges, dig canals, build tanks, power stations, telephone lines, employee houses and other structures on said land, necessary or useful in Lessee's operations in exploring, drilling for, producing, treating, storing and transporting minerals produced from the land covered hereby or any other land adjacent thereto. The land covered hereby, herein called "said land", is located in the County of COUNTY, State of Texas, and is described as follows:

100.00 acres of land, more or less, ...

See "Addendum", attached hereto and made a part hereof, for additional provisions to this lease.

This lease also covers and includes, in addition to that above described, all land, if any, contiguous or adjacent to or adjoining the land above described and (a) owned or claimed by lessor by limitation, prescription, possession, reversion or unrecorded instrument or (b) as to which lessor has a preference right of acquisition. Lessor agrees to execute any supplemental instrument requested by lessee for a more complete or accurate description of said land. For the purpose of determining the amount of any bonus or other payment hereunder, said land shall be deemed to contain **100.00** acres, whether actually contained more or less, and the above recital of acreage in any tract shall be deemed to be the true acreage thereof. Lessor accepts the bonus as lump sum consideration for this lease and all rights and options hereunder

2. Unless sooner terminated or longer kept in force under other provisions hereof, this lease shall remain in force for a term of **Three (3)** years, hereinafter called "primary term", and as long thereafter as operations, as hereinafter defined, are conducted upon said land with no cessation for more than ninety (90) consecutive days.

3. As royalty, lessee covenants and agrees: (a) to deliver to the credit of lessor, in the pipe line to which lessee may connect its wells, the equal one-eighth part of all oil produced and saved by lessee from said land, or from time to time, at the options of lessee, to pay lessor the average posted market price of such one-eighth part of such oil at the wells as of the day it is run to the pipe line or storage tanks, lessor's interest, in either case, to bear of the cost of treating oil to render it marketable pipe line oil; (b) To pay lessor on gas and casinghead gas produced from said land (1) when sold by lessee, one-eighth of the amount realized by lessee, computed at the mouth of the well, or (2) when used by lessee off said land or in the manufacture of gasoline or other products, the market value, at the mouth of the well, of one-eighth of such gas and casinghead gas; (c) To pay lessor on all other minerals mined and marketed or utilized by lessee from said land, one-tenth either in kind or value at the well or mine at lessee's election, except that on sulphur mined and marketed the royalty shall be one dollar (**\$1.00**) per long ton. If, at the expiration of the primary term or at any time or times thereafter, there is any well on said land or on lands with which said land or any portion thereof has been pooled, capable of producing oil or gas, and all such wells are shut-in, this lease shall, nevertheless, continue in force as though operations were being conducted on said land for so long as said wells are shut-ins, and thereafter this lease may be continued in force as if no shut-in had occurred. Lessee covenants and agrees to use reasonable diligence to produce, utilize, or market the minerals capable of being produced from said wells, but in the exercise of such diligence, lessee shall not be obligated to install or furnish facilities other than well facilities and ordinary lease facilities of flow lines, separator, and lease tank, and shall not be required to settle labor trouble or to market gas upon terms unacceptable to lessee. If, at any time or times after the expiration of the primary term, all such wells are shut-in for a period of ninety consecutive days, and during such time there are no operations on said land, then at or before the expiration of said ninety day period, lessee shall pay or tender, by check or draft of lessee, as royalty, a sum equal to one dollar (\$1.00) for each acre of land then covered hereby. Lessee shall make like payments or tenders at or before the end of each anniversary of the expiration of said ninety day period if upon such anniversary this lease is being continued in force solely by reason of the provisions of this paragraph. Each such payment or tender shall be made to the parties who at the time of payment would be entitled to receive the royalties which would be paid under this lease if the wells were producing, and may be paid or tendered **directly to Lessor at Lessor's above listed address**, or its successors, which shall continue as the depositories, regardless of changes in the ownership of shut-in royalty. If at any time that lessee pays or tenders shut-in royalty, two or more parties are, or claim to be, entitled to receive same, lessee may, in lieu of any other method of payment herein provided, pay or tender such shut-in royalty, in the manner above specified, either jointly to such parties or separately to each in accordance with their respective ownerships thereof, as lessee may elect. Any payment hereunder may be made by check or draft of lessee deposited in the mail or delivered to the party entitled to receive payment or to a depository bank provided for above on or before the last date for payment. Nothing herein shall impair lessee's right to release as provided in paragraph 5

hereof. In the event of assignment of this lease in whole or in part, liability for payment hereunder shall rest exclusively on the then owner or owners of this lease, severally as to acreage owned by each.

4. Lessee is hereby granted the right, at its option, to pool or unitize any land covered by this lease with any other land covered by this lease, and/or with any other land, lease, or leases, as to any or all minerals or horizons, so as to establish units containing not more than 80 surface acres, plus 10% acreage tolerance; provided, however, units may be established as to any one or more horizons, or existing units may be enlarged as to any one or more horizons, so as to contain not more than 640 surface acres plus 10% acreage tolerance, if limited to one or more of the following: (1) gas, other than casinghead gas, (2) liquid hydrocarbons (condensate) which are not liquids in the subsurface reservoir, (3) minerals produced from wells classified as gas wells by the conservation agency having jurisdiction. If larger units than any of those herein permitted, either at the time established, or after enlargement, are required under any governmental rule or order, for the drilling or operation of a well at a regular location, or for obtaining maximum allowable from any well to be drilled, drilling, or already drilled, any such unit may be established or enlarged to conform to the size required by such governmental order or rule. Lessee shall exercise said option as to each desired unit by executing an instrument identifying such unit and filing it for record in the public office in which this lease is recorded. Each of said options may be exercised by lessee at any time and from time to time while this lease is in force, and whether before or after production has been established either on said land, or on the portion of said land included in the unit, or on other land unitized therewith. A unit established hereunder shall be valid and effective for all purposes of this lease even through there may be mineral, royalty, or leasehold interests in lands within the unit which are not effectively pooled or unitized. Any operations conducted on any part of such unitized land shall be considered, for all purposes, except the payment of royalty, operations conducted upon said land under this lease. There shall be allocated to the land covered by this lease within each such unit (or to each separate tract within the unit if this lease covers separate tracts within the unit) that proportion of the total production of unitized minerals from the unit, after deducting any used in lease or unit operations, which the number of surface acres in such land (or in each such separate tract) covered by this lease within the unit bears to the total number of surface acres in the unit, and the production so allocated shall be considered for all purposes, including payment or delivery of royalty, overriding royalty and any other payments out of production, to be the entire production of unitized minerals from the land to which allocated in the same manner as though produced therefrom under the terms of this lease. The owner of the reversionary estate of any term royalty or mineral estate agrees that the accrual of royalties pursuant to this paragraph or of shut-in royalties from a well on the unit shall satisfy any limitation of term requiring production of oil or gas. The formation of any unit hereunder which includes land not covered by this lease shall not have the effect of exchanging or transferring any interest under this lease (including, without limitation, any shut-in royalty which may become payable under this lease) between parties owning interests in land covered by this lease and parties owning interests in land not covered by this lease. Neither shall it impair the right of lessee to release as provided in paragraph 5 hereof, except that lessee may not so release as to lands within a unit while there are operations thereon for unitized minerals unless all pooled leases are released as to lands within the unit. At any time while this lease is in force lessee may dissolve any unit established hereunder by filing for record in the public office where this lease is recorded a declaration to that effect, if at that time no operations are being conducted thereon for unitized minerals. Subject to the provisions of this paragraph 4, a unit once established hereunder shall remain in force so long as any lease subject thereto shall remain in force. If this lease now or hereafter covers separate tracts, no pooling or unitization of royalty interests as between any such separate tracts is intended or shall be implied or result merely from the inclusion of such separate tracts within this lease but lessee shall nevertheless have the right to pool or unitize as provided in this paragraph 4 with consequent allocation of production as herein provided. As used in this paragraph 4, the words "separate tract" mean any tract with royalty ownership differing, now or hereafter, either as to parties or amounts, from that as to any other part of the leased premises.

5. Lessee may at any time and from time to time execute and deliver to lessor or file for record a release or releases of this lease as to any part of all of said land or of any mineral or horizon thereunder, and thereby be relieved of all obligations, as to the released acreage or interest.

6. Whenever used in this lease the "operations" shall mean operations for any of the following: drilling, testing, completing, reworking, recompleting, deepening, plugging back or repairing of a well in search for or in an endeavor to obtain production of oil, gas, sulphur or other minerals, excavating a mine, production of oil, gas, sulphur or other mineral, whether or not in paying quantities.

7. Lessee shall have the use, free from royalty, of water, other than from lessor's water wells, and of oil and gas produced from said land in all operations hereunder. Lessee shall have the right at any time to remove all machinery and fixtures placed on said land, including the right to draw and remove casing. No well shall be drilled nearer than 200 feet to the house or barn now on said land without the consent of the lessor. Lessee shall pay for damages caused by its operations to growing crops and timber on said land.

8. The rights and estate of any party hereto may be assigned from time to time in whole or in part and as to any mineral or horizon. All of the covenants, obligations, and considerations of this lease shall extend to and be binding upon the parties hereto, their heirs, successors, assigns, and successive assigns. No change or division in the ownership of said land, royalties, or other moneys, or any part thereof, howsoever effected, shall increase the obligations or diminish the rights of lessee, including, but not limited to, the location and drilling of wells and the measurement of production. Notwithstanding any other actual or constructive knowledge or notice thereof of or to lessee, its successors or assigns, no change or division in the ownership of said land or of the royalties, or other moneys, or the right to receive the same, howsoever effected, shall be binding upon the then record owner of this lease until thirty (30) days after there has been furnished to such record owner at his or its principal place of business by lessor or lessor's heirs, successors, or assigns, notice of such change or division, supported by either originals or duly certified copies of the instruments which have been properly filed for record and which evidence such change or division, and of such court records and proceedings, transcripts, or other documents as shall be necessary in the opinion of such record owner to establish the validity of such change or division. If any such change in ownership occurs by reason of the death of the owner, lessee may, nevertheless pay or tender such royalties, or other moneys, or part thereof, to the credit of the decedent in a depository bank provided for above.

9. In the event lessor considers that lessee has not complied with all its obligations hereunder, both express and implied, lessor shall notify lessee in writing, setting out specifically in what respects lessee has breached this contract. Lessee shall then have sixty (60) days after receipt of said notice within which to meet or commence to meet all or any part of the breaches alleged by lessor. The service of said notice shall be precedent to the bringing of any action by lessor on said lease for any cause, and no such action shall be brought until the lapse of sixty (60) days after service of such notice on lessee. Neither the service of said notice nor the doing of any acts by lessee aimed to meet all or any of the alleged breaches shall be deemed an admission or presumption that lessee has failed to perform all its obligations hereunder. If this lease is canceled for any cause, it shall nevertheless remain in force and effect as to (1) sufficient acreage around each well as to which there are operations to constitute a drilling or maximum allowable unit under applicable governmental regulations, (but in no event less than forty acres), such acreage to be designated by lessee as nearly as practicable in the form of a square centered at the well, or

Figure II- Major Named New Oil and Gas Fields in the United States

(Source: US Energy Information Agency, 2009)

John S. Baen, Ph.D. University of North Texas, College of Business, baen@unt.edu, www.cob.unt.edu/fire1/baen

shale gas map of the united states.gif (GIF Image, 624x448 pixels)

http://www.chelpfultips.com/shale_gas_map_of_the_united_states.gif

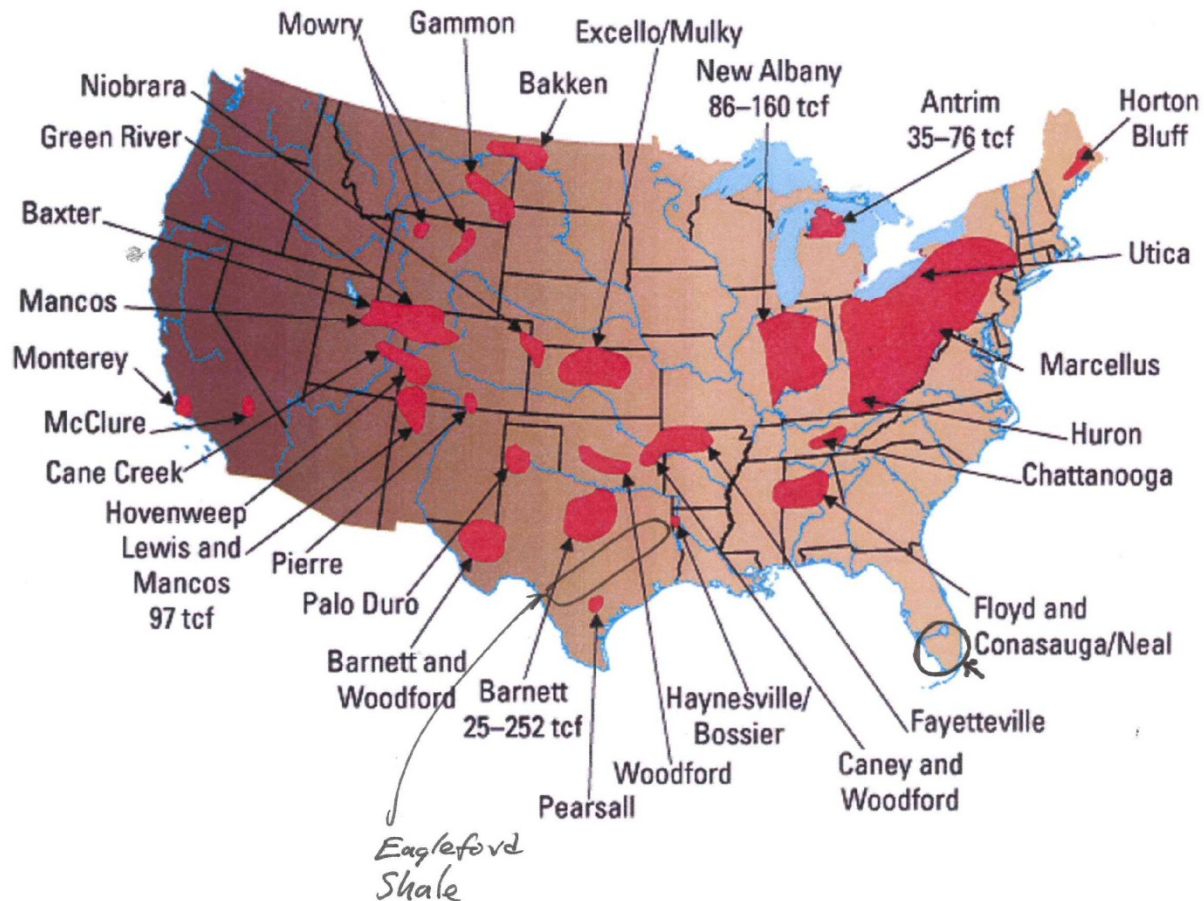
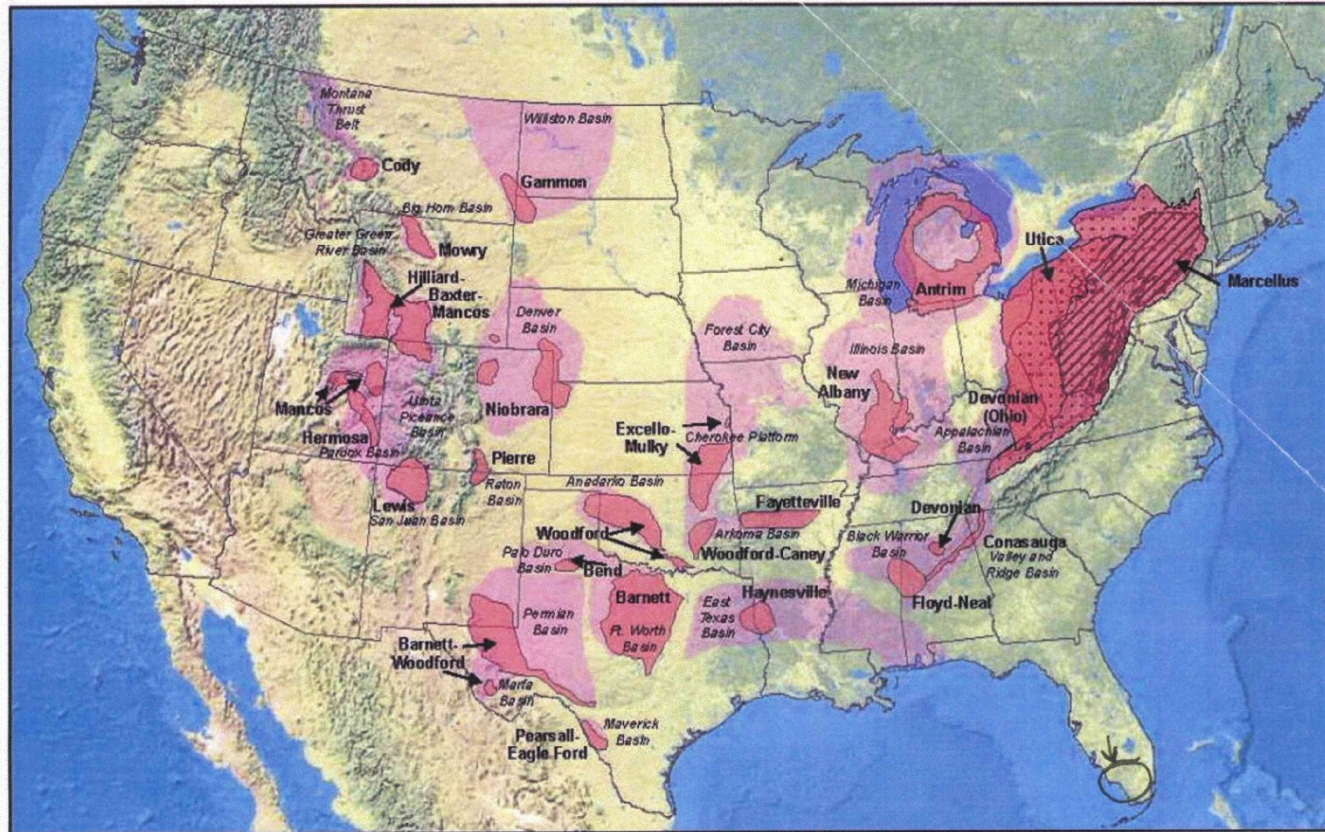


Figure III- United States Shale Gas Plays (Source: US Energy Information Agency, 2009)

John S. Baen, Ph.D. University of North Texas, College of Business, baen@unt.edu, www.cob.unt.edu/fire1/baen

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United States Shale Gas Plays

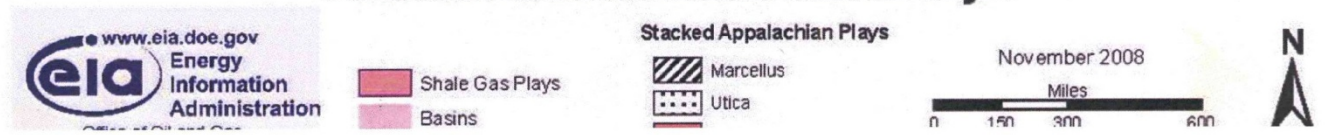


Figure IV- An Overview of Various Rights and Options Transferred at the Time a “Standard Producers 88 Oil and Gas Lease” is Signed

(See Figure I for the “Standard Producers 88 Oil and Gas Lease” paragraphs (p) found below
John S. Baen, Ph.D. University of North Texas, College of Business, baen@unt.edu, www.cob.unt.edu/firel/baen

II. Surface Use Options and Grants (Paragraph 1)

- 1) Exploring, Drilling
- 2) Mining
- 3) Lay Pipelines
- 4) Establish facilities
- 5) Salt water disposal wells
- 6) Construct roads
- 7) Bridges
- 8) Dig Canals
- 9) Build Tanks
- 10) Power stations
- 11) telephone lines
- 12) Employee houses
- 13) “Other Structures, Treating Storing, etc
- 14) Use of Water (free) (p7)
- 15) Drill anywhere, any time, on the property, but not closer than 200 feet from house or barn (p7) (but not future homes or barns)
- 16) Long term easement of access to any well drilled if partial release are required by landowner (p9)

III. Surface Use Options and Grants (Paragraph 1)

- 6) Primary Horizons and options
- 7) Option Periods
- 8) Unlimited Shut-in capped well time @ \$1/acre/ year as “Shut in Royalty” (p3)
- 9) Indefinite Extension in time for any cause beyond control of lessee (p11)

I. Subsurface Use, Options, Transfers, Grants, and Ownership

- 1) Oil and Gas
- 2) Sulfur @\$1/ ton (p3)
- 3) All other minerals (p3)
- 4) 1 well holds all minerals to center of earth (no depth limitation) (p4)
- 5) 80-640 acre pooling-unit provision with other lands/ mineral owners (p4)
- 6) Partial inclusion of total tract in unit may hold 100% of land leased (p4)
- 7) Use by Oil Company of water, oil and gas on site (free and free of Royalty or payment. (p7)

IV. Mineral Owner (Lessor) Requirements

- 1) Warrant Title (p10)
- 2) Defend Title Against All Claims (p10)
- 3) Required to pay Mortgages and Taxes or Oil Company Can Cure (p10)
- 4) 60 day notice of default (p9)
- 5) Request release of oil and gas lease at the end of the term or when production ceases.

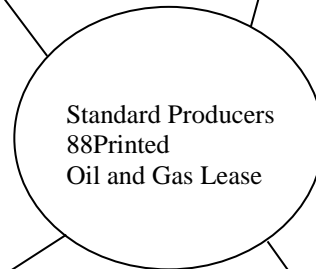



Figure V- TYPICAL TIME TABLE AND PLAYERS OF "STANDARD PRODUCERS 88 OIL AND GAS LEASE" Activity in Virgin Areas of Exploration

John S. Baen, Ph.D. University of North Texas, College of Business, baen@unt.edu, www.cob.unt.edu/firel/baen

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- 1) Major oil company identifies preliminary geological areas of interest and boundary maps based on geology and geotechnical data
 - 2) Oil companies hire outside contractors/ "landman" firms to offer "Standard Producers 88 Oil and Gas Leases" with guidelines, criteria terms and time table:
 - Straw Company established for confidentiality and comparable secrecy
 - Upfront landowners or mineral owner signing bonus money range (\$200-250/ mineral area)
 - Royalty share to mineral owner targets of 1/8th – 3/16th of 100% of production income (12.5% - 18.75% of 100%)
 - 5 year leases offered on primary terms lease, often with 5 year automatic extensions on same terms.
 - 3) "Independent" Landman Teams and Crews (\$250-350/ person/day swarm the county courthouse/ township in search of title information, surface owners and historic mineral owners
 - Searching current surface owners, deeds and historic deeds for current mineral ownership (reverse title search back to statehood).
 - Searching probated wills, family transfers, family trees, and death certificates (testate and intestate loans vary by state).
 - Searching mineral deeds that may have transferred minerals and splint the land estate into:
 - a) surface estate only
 - b) mineral estate
 - Searching databases for current locations, and telephone numbers to contact mineral owners directly or mail "Standard 88 Oil and Gas Lease" and offer letter.
 - 4) Individual lease offers are sent to mineral owners with check or 30 day "DRAFT" attached to be signed. If lease accepted, signed, and notarized title opinion conducted, DRAFT is funded and lease is filed of record.
 - 5) Mineral owners not returning lease offers are contract by individual landman who schedules a meeting at Lessor's location (home or office) to explain and negotiate terms. Often lease is accepted, funded and filed of record as a result of this personal contract meeting.
 - 6) Mineral owners not signing the lease sometimes hire their personal attorney to review the "Standard 88 Oil and Gas Lease" and make changes which may or may not be accepted. (Local attorneys in virgin oil and gas areas often are not experimental or fully trained in oil and gas law and only make changes to major clauses found in leases. After reviewing several "Standard 88 Oil and Gas Leases" and making minor changes, they consider themselves experienced and become the local expert. If they are too vigorous in their changes, the oil company rejects the lease and the Lessor client must pay their legal bill anyway!
 - 7) In "hot" new oil and gas areas, multiple firms negotiate with attorneys on many lease provisions and protective closes.

8) Some mineral owner lessors become "hold outs" with a wait and see attitude for more signing bonus money per acre, more royalty, etc. etc. They may be rewarded by one of the following outcomes

- Successful economic wells are drilled nearby within 5-10 years, and they are rewarded with higher economic benefits

OR

- Wells are never drilled and the leasing opportunity closes, and they "miss out."

Example: signing bonuses in the Barnett Shale DFW, Texas area started at \$500/ acre in 2001 and progressed to \$25,000-\$30,000 per mineral acre and 25% royalties a speculative leasing bubble. For many reasons, in July 2008, the gas boom "busted" and lease prices crashed to \$2,500/ acre in 2011 with 20% royalties. Many areas were completely abandoned for other geological and local political reasons by the oil and gas companies... the pigs got slaughtered no bonus, and no wells.

**Figure VI- “Standard Producers 88 Oil and Gas Lease” Provisions and Lessee
Recommendations for Addendum Language to any Lease**

John S. Baen, Ph.D. University of North Texas, College of Business, baen@unt.edu, www.cob.unt.edu/firel/baen

Grants, Transfer or Options to Oil Company	“Standard Producers 88 Oil and Gas Lease”	Suggestions to Mineral/Surface Owner
1) Surface Uses <ul style="list-style-type: none"> • Employee Housing • Power Stations • Canals • Mining • Build Facilities • Compressors • Pipelines • Disposal Wells • Etc, etc 	Stated/ Unlimited	Delete
2) Substances or Rights to Explore, Mine, Drill, Use, Etc. <ul style="list-style-type: none"> • Oil and gas • Sulfur • Water • Uranium • Etc 	Stated/ Unlimited	Delete all but oil and gas
3) Reasonable Damages Paid for Surface Uses	Silent/ generally addressed late by “private treaty” informally or none paid	Negotiable
4) Negligence Damages and/or Insurance Coverage for Landowner by Oil Company	Silent	Add to Leases
5) Number of Drill sites	Silent/Unlimited	1 Drill site/ 160 acres (variable by state field rules) depths, etc.
6) Size of Drill sites	Silent/ Unlimited	2-4 acres/ max/ drill-site
7) Size of Production Sites	Silent/ Unlimited	½ - 1½ acres where all equipment is located after drilling
8) Location of Access Roads	Silent/ Unlimited	Designate or Lease Land Plan Drawing or with prior to disturbance of soil, or mutual agreement provisions
9) Electric Line	Silent	Mutual Agreement with option to have land owner have access to electric lines
10) New Water Wells/ Water	Silent/ Unlimited	To be owned by surface owner, water purchased at 25¢ per barrel
11) Surface Damages paid per drill site and per ft of road	Silent/ Unlimited	Value of land/ acre disturbed, paid as damages (not taxable @ time zero)
12) Tree Removal	Silent/ Unlimited	Only with mutual consent and/or

		monetary damages. (Trees that are 6 inches or larger in diameter?)
13) Restoration of Surface/ Pads etc	Silent/ None	Gravel removed and grass established within 6-24 months of abandonment
14) Equipment, Rigs, Pipe, Supplies stored on site	Silent/ Unlimited	Restrict or ban without separate agreement
15) Maintain Environmental Standards and Restrict Toxic Chemicals storage on site	Silent/ Unrestricted	Provisions added
16) Saltwater disposal wells	Allowed without limitations	Delete from Lease or obtain royalty of "fee" on every barrel disposed of
17) Seismic Studies and Geo Tech Studies on Surface	Unlimited/ Unrestricted	By separate agreement or add damages of \$5-10 acre and no tree cutting, hand carried cables only in sensitive areas
18) Access gate security for safety	Silent	Require a <u>single</u> lock and copy of key for landowner (often 5-6 lots/gate)
19) Naming of Wells- Naming Rights	Silent	Ask to dedicate well names for family members such as "JP Smith" #1, #2, etc
20) Depth Limitations on "held rights" under Lease	Unlimited	200 feet below deepest economically producing zone. (Ask for release of deep rights after drilling and expiration of primary term.)
21) Plugging and Abandonment	Silent	Require within 2 years of no production and site cleanup or penalties
22) Formal Release of lease/ Cancellation	Must be Requested	Automatic termination for non-production or expiration
23) Restoration of Surface after Abandonment	Silent	Require restoration, planting, fertilization within 6 months of abandonment
24) Assignment of lease to other Oil Companies	Allowed	Allow assignments only with written permission and without release of liability or agreements.