

Oil and Gas Lease Bonus Payment
Author: Daniel W. Jones, Esq.
Coan, Payton & Payne, LLC

Because of the recent dramatic increase in oil and gas exploration activity, many landowners in northern Colorado either have received or will receive one or more letters in their mailboxes that contain language something like this:

“Dear [Landowner], We are in preparations to drill an oil and gas well for which our records indicate your property will have a share of the proceeds from production. Therefore, we are interested in entering into an Oil and Gas Lease with you, and will offer to pay you \$500 per net mineral acre that you own as a signing bonus. Our initial research indicates that you own 20 acres, which would translate to a payment of \$10,000, and our proposed Oil and Gas Lease is enclosed for your review. Should you decide to accept this offer, please sign the enclosed Oil and Gas Lease in the presence of a notary and return it to our office. Upon receipt, we will deliver to you a draft for payment of the lease bonus based on the acreage you own, which will be payable within sixty (60) business days. Please feel free to contact me should you have any questions. Sincerely,
[Landman for XYZ Exploration Company]”

While landowners have varied reactions to the receipt of such letters, it is difficult for most landowners not to develop some high hopes when bonus payments are offered for tens of thousands, or even hundreds of thousands, of dollars. Images of new cars, home improvements, college or retirement funds, debt payoffs, or dream vacations may soon come to mind.

However, unless the receiving landowner is certain about the status of their mineral interests, such excitement should be tempered until all of the steps of the process of completing an Oil and Gas Lease are finished. Why? Because it is not uncommon to find that a contacted landowner does not own all of the mineral interests initially described in that first letter received from the landman.

When an oil and gas producer sets its sights on a particular area of land, it tries to get leases with all potential owners of the mineral interests underlying that land as quickly as possible, particularly when there are competing oil and gas producers exploring for oil and gas in the same area. The goal of the producer is to wrap up the leases as much as possible before the competition arrives. In the process, the producer from which a landowner receives such an initial offer to lease their lands may have done only a cursory initial search of the property records.

Because the producer’s initial property search likely was cursory, upon execution of an Oil and Gas Lease by a landowner (“Lessor”), the oil and gas producer seeking the lease (“Lessee”) will not deliver to Lessor a check for immediate payment, but instead will deliver to Lessor a promise to pay the bonus payment for the signing of the lease in the form of a draft or an “Order for Payment.” The draft or Order for Payment will contain express limitations on the amount to be paid to Lessor, which limitations will be subject to Lessee’s confirmation that

Lessor actually has title to the mineral interests the landman for Lessee described in the initial letter.

For example, in the sample letter set forth above, upon Lessor's execution of the proposed Oil and Gas Lease, XYZ Exploration Company as Lessee would provide an Order for Payment to Lessor in the amount of \$10,000, promising to pay \$500 per net mineral acre within sixty (60) business days, "subject to Lessee verifying Lessor's net mineral acre ownership, as determined solely by Lessee." Lessee does not wish to go through all of the time and expense of a thorough mineral title search until Lessor, as a potential mineral owner, executes the Oil and Gas Lease for the benefit of Lessee.

Once Lessee has the executed Oil and Gas Lease from Lessor in hand, Lessee then will invest the time and money to do a thorough search of the mineral title records applicable to Lessor's lands. Because mineral ownership can be severed from surface ownership in Colorado, this more-thorough search of the mineral title records by Lessee can, and often does, reveal the existence of separate and/or additional owners of the mineral interests underlying Lessor's lands. While Lessee may have indicated that Lessor owned twenty (20) acres in its initial letter, the additional mineral title research may show that Lessor actually owns only a fractional interest in the minerals underlying that land, such that Lessor actually only owns two (2) net mineral acres. Instead of a bonus payment of \$10,000 for executing the lease, Lessor then would receive a bonus payment of only \$1,000. While this may still be a nice amount of money to receive, it is nowhere near the potential amount initially suggested in the landman's letter.

While infrequent, there are even times where Lessee's additional mineral title research reveals that the Lessor does not, in fact, own ANY of the mineral interests underlying the surface lands owned by Lessor, in which case the Lessee would receive no payment at all. Lessee may have incurred some expense of time and money for review and negotiation of lease terms, only to find that there is no mineral interest to lease in the end.

When receiving letters from oil and gas producers expressing interest in leasing lands, which letters often imply a sense of urgency, it is important for landowners to be aware that a timely but cautious and educated approach to the process is necessary. The oil and gas attorneys at Otis, Coan & Peters, LLC can help you navigate through the process of leasing your mineral interests in a way that seeks to maximize your benefits and limit your risks.

Daniel W. Jones is an attorney at Coan, Payton and Payne, LLC. He can be reached at 970-339-3500 or djones@cp2law.com.