

## COAL BED METHANE GAS LEASE NEGOTIATIONS ON BEHALF OF LANDOWNERS

### INTRODUCTION

**Most royalty owners living in Southwest Kansas have no interest in coal bed methane gas production because it is foreign to our area and yet the subject should be of interest to those of us interested in natural gas production in general.** Surprisingly, according to **Timothy R. Carr**, of Lawrence, Kansas, Chief of the Petroleum Research Section for the Kansas Geological Survey, **10% of the natural gas produced in the United States comes from coal bed methane gas (CBM) and 55% of the natural gas produced in Colorado comes from CBM production.** Tim predicts that CBM production in eastern Kansas may eventually rival gas production from the Hugoton Field.

I became interested in the subject of CBM production several months ago when I started receiving calls from landowners in Eastern Kansas wanting help in negotiating leases for coal bed methane gas production. They were being offered a nominal bonus with 1/8th royalty and my advice to them at the time was not to lease because the consideration was not adequate to justify tying up their land at that price.

One interesting call I did receive was from a landowner in Hutchinson whose family owned land in Oklahoma and he was looking for an Oklahoma attorney to represent him on the question of ownership of the coal bed methane gas underlying his land. I was able to refer him to an Oklahoma City attorney who had given a talk last summer on that very subject. In the course of our conversation, the landowner told me he had been offered a bonus of \$50.00 per acre for a lease covering several thousand acres and 3/16ths royalty.

### RESEARCHING SUBJECT OF COAL BED METHANE GAS DEVELOPMENT IN KANSAS

**Leasing of land for coal bed methane gas was foreign to me so I decided to do some research on the subject and was intrigued with what I was able to learn. My research led me to an interesting and informative article published in December 2001 by the Kansas Geological Survey, Public Information Circular 19, entitled, "Natural Gas from Coal in Eastern Kansas," by Robert S. Sawin and Lawrence L. Brady, members of the Survey.**

**The article revealed that coal bed methane is natural gas that occurs in coal beds. The geological process that turns plant material into coal generates methane gas. Coal is the most abundant energy source in the world and coal deposits have been mined in Kansas for nearly 150 years, mostly in southeastern Kansas. For years, coal mines had to be ventilated to remove the deadly methane gas but in the early 1980s, the mining industry began to capture and sell the gas rather than release it to the atmosphere.**

**Coal bed gas production began in Kansas in the mid-1980s and has increased dramatically in the last couple of years.** In visiting with Tim Carr just this week, Tim advises me there are currently at least 800 producing CBM wells in eastern Kansas at latest count. Seven CBM wells

were drilled and completed in 2000. This number increased to 152 well completions in 2001 and 126 completions reported so far for 2002 with reporting figures lagging six months behind. Tim also confirmed that just in Neosho County alone, assessed property valuations have increased 15 fold in the last two years as a result of CBM activity in that county.

**Most of the activity has been in the southeastern part of the state, primarily in Montgomery, Neosho, Wilson, western Labette, and eastern Chautauqua counties.** However, other parts of eastern Kansas underlain by coal beds have potential for CBM production. **A map in the Geological Survey article shows potential coal bed methane gas production in Kansas lying east of line extending from the southeast corner of Sumner County in south central Kansas in a northeasterly direction across the state to the eastern portion of Nemaha County, the third county lying west of the northeast corner of the state.**

**Coal contains gas and lots of water and therein lies part of the problem of producing gas from coal beds.** According to the Survey article, naturally occurring fractures provide the plumbing system within the coal that allows water and gas to travel through the coal to the well. **For gas to be released from the coal, the pressure must be reduced by removing water from the coal bed, a process called dewatering. In Kansas, most of the water is saltwater and is re-injected deep underground.** The amount of gas in coal depends on the degree of alteration the coal has undergone in the burial process, the depth below the surface, and the pressure of the reservoir. **Coalbed methane, when burned, generates as much heat as petroleum-based natural gas.**

The Survey article recites that bituminous coals of eastern Kansas have great potential for large quantities of methane. **Up to 14 beds may be encountered in a well but the primary concern is the thinness of most of the coal beds in Kansas. Geological logs show that about 96 percent of the coal occurs in beds 14 to 42 inches thick and only four percent occurs in beds greater than 42 inches.**

**Most of the coal beds in eastern Kansas are less than 2,500 feet deep, with wells as shallow as 500 feet, so drilling costs should be relatively low. Many gas pipeline networks already exist and Kansas has recognized disposal zones for water produced with the methane.** Those factors suggest that eastern Kansas is an important area for potential development of coal bed methane gas and that is being borne out with the flurry of leasing activity in several eastern Kansas counties in recent months. **Large companies like Devon Energy Production Company from Oklahoma City, Calpine, a utility company operating out of Denver, Dart operating out of Michigan, Berry Energy, Quest Development Company, and Colt Energy, among others, are leasing up large chunks of acreage throughout eastern Kansas, including blocks ranging from 150,000 acres to 400,000 acres.**

**Much of this acreage is being leased by lease brokers for a nominal bonus of \$5.00 per acre and 1/8th royalty for a five year paid-up lease, and in some instances with an option to renew the lease for another five years. I have heard from a pretty reliable source that lease brokers**

**are then turning around and peddling the leases for as much as \$30 to \$40 per acre with a 1/16th overriding royalty.**

**RESEARCH CONFIRMS UNIFORMED KANSAS LANDOWNERS EXECUTING LEASES BELOW MARKET VALUE**

After negotiating leases on behalf of landowners in western Kansas and eastern Colorado for many years, it is my firm opinion that uninformed landowners are leasing their lands for CBM production for less than market value. At the same time, landowners are accepting lease terms favoring the lessee to their detriment, not recognizing the importance of protecting the surface use of the land. **For years, I have taken the position that 1/8th royalty is no sacred cow and a royalty of at least 3/16ths is more fair to the landowner. I also feel that a minimum bonus of \$15.00 per acre for executing the lease as compensation for use of the surface is not unreasonable or out of line. I also insist that my client not sign a paid-up lease but require the payment of delay rentals during the primary term on the lease.**

Years ago, I had a client approach me to draft a "landowner's oil and gas lease" after a major oil and gas company operating in the field had offered him a substantial bonus to sign a lease on unleased acreage in the heart of the Hugoton Field. I jumped at the opportunity. I wanted to be fair to the oil and gas company and yet protect my clients's interest so I took the most favorable lease to a landowner I could find in the Hugoton Field and then added additional paragraphs to cover problems encountered by landowners in dealing with the oil and gas companies operating in the Field over the years. It resulted in taking the L.B. 88 Revised form lease prevalent in the field and adding three pages of addendum to protect the landowner. Among other things, the lease provides for 3/16th royalty instead of 1/8th. My client also received a bonus of \$100.00 per acre for signing the lease with a major oil company and that was years ago, as I say.

In our law office, we refer to our lease as the KNN lease form and addendum and it has been pretty well accepted for many years by numerous oil and gas companies because the lease is fair to both the lessor and the lessee.

**GENERAL RESEARCH ON CBM DEVELOPMENT PAYS RESULTS**

**The main reason I was reluctant to talk with anybody about leasing their lands for coal bed methane gas was that my KNN oil and gas lease form was not broad enough to protect the landowner from dewatering problems encountered in CBM production, or protect the landowner from the extensive use of roads to maintain the wells or haul off salt water, the laying of water and pipelines and the problems encountered with large pooling units needed to make the operations more cost-effective. Other problems include the installation of compressor sites, the necessity for continuing the lease in effect after the primary term before production is obtained, and the allocation of royalties within a large pooling unit.**

In an effort to draft a CBM lease that would be fair to both the landowner-lessor and the lessee-producer, I went on the internet and was surprised at how much information there was available on the subject. One of the first sites I found was that of the Bureau of Land Management in Wyoming discussing the Atlantic Rim Coalbed Methane Project involving some 300,000 acres owned by the federal government. **The Environmental Impact Statement filed in that project revealed that the federal government had stringent requirements for the use of the surface. Some of the requirements, among numerous other things, are:**

- 1. Specifies the amount of acreage to be used for the wellsite.**
- 2. Requires maintenance of existing roads and made provisions for access road requirements.**
- 3. Restricts use of roads to one vehicle per day and designated size of vehicle.**
- 4. If well is productive, requires access routes to be upgraded to all weather roads to provide for year around service.**
- 5. Provides for graded wellpad with dimensions of 180 feet by 200 feet.**
- 6. Provides for two buried pipelines, one for transportation of water and one for transportation of gas to be placed in same ditch at least four feet in depth to prevent freezing of pipelines.**
- 7. Contains stringent requirements for pits and fencing of pits.**
- 8. Makes provisions for conservation of top soil.**
- 9. Contains provisions for reclaiming and restoring surface.**
- 10. Requires removal of all debris and waste materials immediately after removal of the drilling rig.**

Thinking that the Bureau of Land Management would have a lease form covering coal bed methane gas production, I called the BLM offices in Rawlins and Cheyenne, Wyoming, only to learn that the government uses a regular lease form for normal oil and gas operations but has the environmental impact statement to protect surface use, along with other stringent federal regulations dealing with oil and gas production.

Noting that Canada had a website on CBM production, I called a Canadian government official in Victoria, British Columbia, and learned that the Canadian government does not have a special form for leasing for coal bed methane gas either. That official was kind enough to refer me to a lease

brokerage firm in Calgary but it turns out the lease forms they use in Canada make no specific reference to CBM. The lease broker referred me to a royalty owner group in Calgary but they had only been founded in 1989 and were just getting their feet wet on the problems encountered in CBM production.

#### PROBLEMS ENCOUNTERED WITH CBM DEVELOPMENT AND PRODUCTION

Several of the CBM articles I found on the internet dealt with problems surface owners were experiencing in the development by the gas companies of lands in Wyoming and Colorado for coalbed methane gas production. Groups of landowners had been formed to fight against coal bed methane. **One such group was the Grand Mesa Citizens Alliance in Delta County, Colorado who were concerned about the damaging effects that coal bed methane gas drilling and production activities can have on the quality of life and economic stability in their county.** The stated mission of the group is to act to protect the health, safety and welfare of the people in the watersheds of Delta County from the adverse effects of oil and gas exploration and production activities in those watersheds.

**Perhaps the strongest landowner group in Wyoming is the Powder River Basin Resource Council, headquartered in Sheridan, Wyoming, and organized for the purpose of protecting the Powder River Basin from irresponsible coal bed methane development.** The focus of the organization is to help those property owners who own their surface and do not own the minerals below them. In Wyoming and apparently in Colorado much of the land has divided ownership with farmers, ranchers, individuals and the federal government owning the surface and other parties, including the federal government owning the minerals underlying the land.

According to a press release appearing at its website at [www.powderriverbasin.org](http://www.powderriverbasin.org), dated February 18, 2003, the United States government is proposing to drill some 66,000 coal bed methane wells in just twenty years on 13 million acres in Wyoming and Montana. The Council is concerned that the project will result in drained aquifers, polluted rivers, damaged farm and ranch land, and a loss of wildlife. **The Council contends that domestic and stock water wells are drying up or becoming contaminated with gas or other development-related constituents.**

**The Council also has concerns about, among other things: (1) noise from motors in the compressor stations and generators; (2) lower property values because of the encumbrances under the oil and gas lease; (3) damages from water pumped onto the surface; (4) increased risk of water damage to the neighbors from water coming from lease operations on your property; (5) soil erosion and noxious weeds; (6) excessive use of roads to service the wells; (7) construction of gas gathering pipelines, water lines, large pipelines, power lines and electrical stations; (8) construction of well heads, pumps and compressor stations on your property that give you increased noise and exhaust emissions; (9) potential loss of your current well or the need to increase the depth of your water well to be able to pump water; (10) damages to fences; (11) increased risk of wildlife poaching; and (12) litter.**

COMPENSATION BEING PAID IN WYOMING AND COLORADO FOR SURFACE USE

**It was through Jill Morrison, spokesperson and organizer of the Council, that I was able to obtain the names of several Wyoming attorneys and lease brokers to ask for their input as to provisions to put in a CBM lease to protect the landowner. At the time I visited with Jill a couple of months ago, she said they were swamped at the time dealing with the proposal of the Bureau of Land Management to drill 40,000 new CBM wells in their area!**

**Incidentally, any one interested in becoming more knowledgeable about problems encountered in CBM development should check the Powder River Basin Resource Council website or contact Jill Morrison. Their address and telephone number are 23 North Scott, Sheridan, Wyoming 82801, Telephone No. (307) 672-8905. Jill's telephone number is (307) 672 -5809.**

**I learned from the Wyoming attorneys and lease brokers that because of the divided ownership between surface and mineral owners, most of the oil and gas leases in Wyoming, including coal bed methane gas leases, do not contain provisions dealing with surface use of the land other than the right to use so much of the surface as to carry out the lease operations. Consequently, they have available for their landowner clients Surface Use and Damage Agreements, Water Well Mitigation Agreements, Right-of-Way Agreements, and the like. In case you are interested, some of these agreements are available at the Powder River Basin website.**

**The most surprising and enlightening thing I learned in all of my research and telephone visits with various people about CBM development was that the surface owners in Wyoming and Colorado have been able to negotiate not only initial payments, but annual payments as well, for well locations, roads, pipelines and water lines, and gathering, metering and compressor sites, and usually a one-time payment for power lines.**

**One attorney advised me he usually requires an initial payment of \$1,000 per well location and annual payment of \$1,000 per year. This is based on the use of a half acre of land and the requirement of truck mounted rigs because the wells are very shallow (500 feet) and can be drilled even with a water well rig. He requires a higher payment if they use heavier equipment to drill the well. He normally gets \$15.00 per acre for seismographing.**

**This same attorney negotiates for use of existing roads at \$1,000 per mile per year without specifying the location of the road. On new roads, he tries to negotiate on a per square foot basis rather than lineal foot. The roads are usually 16 ½ feet wide and if the company wants more, they are required to pay more. This attorney did indicate he was able to negotiate royalties at 17% to 20%, with bonuses ranging from \$100 to \$350 per acre, depending on the closeness to production. Amazingly, this attorney told me that the payout of some of the CBM wells is three or four days and most are just a few months payout!**

**Another Wyoming attorney advised me that he usually is able to negotiate at least 18%**

royalty. For each well hole, he is able to negotiate an initial fee of \$1,000 to \$1,500 and an annual rental of \$1,000 per well hole. For roads and pipelines, the going rate varies between \$5.00 to \$10.00 per rod. Also, he has negotiated an initial payment of \$5.00 per rod for roads and a reduced annual payment of \$3.50 per rod. On pipelines, the compensation is determined at the rate of \$2.00 per inch. For example, a four inch line would require an initial payment of \$8.00 per rod and an annual payment of \$4.00 per rod. Likewise, for an eight inch line, the initial payment would be \$16.00 per rod, with an annual rental of \$8.00 per rod. Some of the companies operating in his area are Williams, Devon, Anadarko, and Phillips.

Another Wyoming attorney confirmed he requires an initial payment of \$1,500 for each well site and an annual rental of \$1,500 per year. He indicated his clients receive about \$5.00 per rod for roads, pipelines, and power lines per year and for large compressor sites they get as much as \$5,000 per year.

In visiting with a landowner attorney from Durango, Colorado, who shared with me the oil and gas lease forms and surface use agreement forms he uses. He indicated wellsite damages ranged anywhere from \$5,000 to \$25,000 per site. They use a rule of thumb of one-half the value of the land in determining wellsite damages in the Durango area. He told me land there sells for several thousands of dollars per acre. Wellsites are limited to six tenths of an acre. They also receive compensation for use of roads, pipelines, and compressor sites. He is able to negotiate substantially higher figures for well sites in Colorado and one of the leases he shared with me provided for 20% royalty.

#### CONCLUSION

From all of the information I have been able to obtain in researching the question of coal bed methane gas development and production in Wyoming and Colorado, as well as Oklahoma, it would seem to me a prudent and informed Kansas landowner should be able to negotiate better lease terms than those currently being offered by lease brokers in the potential development of coal bed methane gas production from the coal beds underlying eastern Kansas.

Thank you for the opportunity to share with you my research on the subject of CBM development in Kansas.

**(Speech prepared by Bernard E. Nordling, SWKROA Assistant Executive Secretary, for presentation at the 55<sup>th</sup> annual meeting of the Southwest Kansas Royalty Owners Association in Hugoton, Kansas, on April 26, 2003)**