Mineral Lease Agreement Terms

Understanding the terms found in a mineral lease agreement is important for mineral owners. If the mineral lease agreement terms are not favorable for the mineral owner, you could lose out on a significant amount of money. Below we describe some of the most important lease agreement terms and how they will affect you!

Lease Bonus

The lease bonus is one of the most important portions of the mineral lease agreement terms. The lease bonus is the amount you will be paid **immediately** for the **right** to drill on your property and extract oil and gas minerals. To explain this another way, this is payment for the exclusive right to drill on your property for the term of the lease agreement. Since the oil and gas company has the exclusive right to drill on your property based on the mineral lease agreement terms, the lease bonus is compensation for locking up your property during the lease terms.

As a mineral owner, you want to receive the highest lease bonus possible. This up front lease bonus amount is paid up front in cash to secure the right to drill before any activity takes place. This means that the lease bonus is the ONLY guaranteed money you will get over the term of the lease. The oil and gas company may not end up drilling on your property before the lease expires. If they do drill, it's possible the well may not produce enough to be economic and never pay out any type of royalties.

As a mineral owner, you want to balance the amount you will receive up front with the royalty % you may receive in the future. You can typically negotiate a higher guaranteed up front lease bonus in exchange for a lower royalty. You can also negotiate for a lower lease bonus in exchange for a higher royalty. Each situation is different and one mineral owner may wish to get a larger bonus up front and another may wish to negotiate for a higher royalty percentage hoping for higher royalty payments in the future.

Lease Agreement Royalty Percentage

One of the more important lease agreement terms is the royalty percentage. The royalty percentage will determine your share of the future production in any well that's drilled. Even a 1% royalty increase can yield a **significantly** higher amount of money for the mineral owner in the future. As a mineral owner, you have to determine if an up front bonus payment is more important or if the potential for higher royalty income in the future is.

Another important factor is to know what royalty percentage is common in your area. Royalty percentage can range anywhere from 12.5% to 25%. Knowing what's common in your area is important so you can negotiate appropriately and get the highest royalty percentage possible. NARO members have access to current leasing information.

Lease Agreement Term

Another important factor on your lease agreement is the term, or how many years, your lease agreement is for. The lease agreement term is important because this determines how long the oil and gas company has exclusive rights to drill on your property. A shorter lease term is more favorable for a mineral owner because it forces the oil and gas company to drill sooner or the lease will expire. A longer lease term is more favorable for the oil and gas company because it gives them a longer period of time to drill. This means they do not have as much incentive to move quickly and drill on the property. As a mineral owner, you want to negotiate for the shortest lease term possible so that you can lease the property again and collect another lease bonus if no drilling takes place.

In addition to the initial lease term, many oil and gas companies will include an "optional extension" into the agreement. This optional extension is typically for the same term as the original lease. If the original lease was for 3 years, the optional extension will also be for 3 years. The optional extension means that the oil and gas company has the option to extend the lease for an additional period of time. As the owner, you do NOT have any choice if you grant an optional extension. This means that a 3 years lease with an optional 3 year extension should really be viewed as a 6 year deal.

The benefit to the mineral owner, is that an optional extension will also have another lease bonus attached to it for the extra period of time. This means that the oil and gas company will need to pay you an additional lease bonus at the end of year 3 to continue the lease for the next 3 years with the optional extension. The lease bonus for the optional extension will sometimes be equal to the original lease bonus amount and in some cases it will be higher. An optional extension should NEVER have a lower lease bonus amount than the original lease bonus.

Other Lease Agreement Terms

In addition to the other mineral lease agreement terms above, there are also other lease terms which are important for the mineral owner. Clauses such as the Pugh Clause should be included in every lease agreement for the mineral owners protection. There is no standard lease agreement that every company uses so each lease agreement will be different. It's important to have a qualified professional review your lease before signing to ensure the lease is in your best interests. NARO can refer you to a Certified Mineral Manager.

If you're looking for an attorney to help you with your mineral lease agreement terms, you might consider alternative options, like a mineral manager first. The reason is that traditional attorney's will review a contract to see if there is any language that may not be in your best interests (which is good). However, unless your attorney specializes in Oil & Gas law and specifically in the leasing of mineral rights, they may not know about oil and gas specific clauses and language that should be included to protect the mineral owner but are not.

On countless occasions a lease agreement that was "reviewed by an attorney" and found numerous errors and omissions that were harmful to the mineral owner.