Sometimes, oil and gas leasing can get ugly

Washington—There is a nasty and ugly side to the widely celebrated oil and natural gas boom that the US has enjoyed in recent years — a side that involves allegations of fraud, breach of contract and taking advantage of poor or unsophisticated landowners, among other things.

Industry officials, attorneys and others interviewed for this story said that because so much new drilling is taking place on private lands that are owned by individuals who have their own unique agendas, conflicts between landowners, oil and gas companies and state regulatory agencies are on the rise.

This story is about some of those conflicts.

Neil Ray of the National Association of Royalty Owners, a Tulsa, Oklahoma-based group that helps people get fair returns on their mineral rights, is at ground zero of this fight. Ray said one of the most common complaints he hears from landowners is that oil and gas companies “lock up” huge tracts of land by abusing a legitimate leasing provision known as “held by production,” or HBP. Ray said companies can do this by drilling just one well on a given tract of land, even though they actually need to drill more wells — sometimes many more — to effectively drain the land of its oil and gas.

Ray said that while companies often come back and drill those additional wells months or years down the road, that development frequently does not come soon enough for mineral-rights owners, who sometimes struggle financially or even die prior to seeing any substantial oil and gas royalties from the leases they signed.

Ray, who heads up NARO’s Rocky Mountain chapter, said mineral-rights owners have coined a special term to describe instances where oil and gas companies “lock up” huge tracts of land by abusing a legitimate leasing provision known as “held by production,” or HBP. Ray said companies can do this by drilling just one well on a given tract of land, even though they actually need to drill more wells — sometimes many more — to effectively drain the land of its oil and gas.

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Ray, who heads up NARO’s Rocky Mountain chapter, said mineral-rights owners have coined a special term to describe instances where oil and gas companies abuse the HBP provision: “The [expletive] ‘em and hold ‘em clause.”

“It’s getting worse,” Ray said. “It’s happened since the 1920s, but it is actually getting worse. The exploitation of these rules and these laws that fly in the face of fairness and common sense and science is getting much worse.”

Battle in the Bakken

One such conflict involving HBP and other, even more explosive issues is set to play out in November in the Williams County Courthouse in Williston, North Dakota, in the heart of the Bakken shale play. This dispute involves six family members who leased their Bakken mineral rights to Golden Eye Resources LLC, a Denver-area company that employs so-called "landmen" who negotiate oil and gas leases between mineral-rights owners and drillers.

Debra Ganske of Minot, North Dakota, who served as her family's lead negotiator with Golden Eye's two landmen, said the oil and gas on their property is not being developed fast enough.

"If my acres weren’t tied up by production from a single well, then I could make other arrangements to get my minerals developed," Ganske said. "The spacing unit where my minerals are located, there’s only one well, but down the road, there’s [more] wells in the same size unit. So I don’t have the same opportunity to get as much [royalties] as the guy down the road."

But Ganske’s dispute with Golden Eye goes far beyond the HBP clause in her lease. Ganske claims that Golden Eye "fraudulently induced" her family into leasing its Bakken mineral rights by making false statements, and by withholding key information about its ability to drill horizontal oil and gas wells in the Bakken shale.

Specifically, Ganske said that a few months after signing the leases, she discovered that Golden Eye had only a 19% interest in the Bakken spacing unit where the majority of her family’s mineral rights were located. Moreover, Ganske said Golden Eye never told her that in order to drill on her family’s land, it first had to join forces with another firm, and then thwart plans by another operator — Dallas-based Petro-Hunt — to drill in the same spacing unit.

Based on those and other alleged findings, Ganske informed Golden Eye in writing that she was “rescinding” her family’s leases so they could contract with another operator to develop their land. But she also proposed an alternative
"compromise" approach in which Golden Eye would pay her family a higher royalty rate and a higher per-acre signing bonus for developing the land, matching an offer she said she got from another company. In a letter to Golden Eye, Ganske said she would accept the compromise approach has long as Golden Eye did not "engage in any gamesmanship."

"It is now apparent that most, if not all, of the representations that you made to me and my family to induce us to lease our minerals ... were false," Ganske told Golden Eye in her letter.

**Defamation and shakedown?**

Golden Eye did not respond favorably to Ganske's letter. The company sued her to "quiet title" to the disputed leases, as well as for breach of contract and for intentionally interfering with a contract. Charles Neff, Golden Eye's Williston-based attorney, told Ganske in a letter that her "compromise" offer was an "outrageous and ... bad faith ... shakedown" effort designed to force Golden Eye to pay her family more money.

Neff also threatened to sue Ganske for "commercial defamation," saying her "untrue defamatory statements" could cause Golden Eye to "lose a prospective lease" or "damage its reputation in the market area for oil and gas leasing."

"[Golden Eye] takes the validity of the oil and gas leases negotiated in good faith and paid for ... very seriously, and intends on prosecuting this complaint very vigorously to protect its legal and contractual rights," Neff told Ganske in his letter.

Ganske, for her part, told Platts in an email that she and her family have been badly shaken by the whole episode.

"I am terrified to engage in any discussion of the underlying facts relevant to pending litigation," she said. "My family members and I have endured overwhelming stress and costs for over two years. These claims for money damages are costly to defend — even if ultimately ruled to have no merit — and have the inevitable effect of chilling my speech."

After sending that email, Ganske stopped communicating with Platts.

Ganske's trial is slated to begin on November 7. The trial, which is scheduled to last three days, will also consider Ganske's counter-suit against Golden Eye, which seeks to confirm the legality of her efforts to rescind the leases that she and the other members of her family signed.

Golden Eye declined to comment for this story. And before she stopped talking to Platts, Ganske said she was preparing to sue the North Dakota Department of Mineral Resources, the state regulatory body, over its policy of setting "spacing units" for oil and gas wells in the Bakken. The department generally sets those spacing units at 1,280 acres, or two square miles, which Ganske contends is far too large. Ganske said the department picked that number to allow oil and gas companies to lock up large tracts of land by drilling just one well, which she argues does not protect mineral owners' rights.

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**Some cash in on a hunch, while others miss out**

Thirty years ago, few people could have predicted that exploration and production companies would someday be able to extract huge amounts of oil and natural gas from tight underground shale formations. But some Louisiana landowners were recently rewarded with a nice big payday because of a hunch that their lawyers had during the Nixon and Ford administrations.

Randall Davidson, now an attorney at Davidson, Jones & Summers in Shreveport, Louisiana, graduated from law school in 1976 — three decades before oil and gas companies began tapping into Louisiana’s Haynesville Shale. In an interview, Davidson recalled that when he was fresh out of law school, he and a more experienced colleague helped structure an oil and gas lease for a big Louisiana cotton plantation south of Shreveport.

Davidson said he and his partner knew the Haynesville formation was there, but they believed it was “worthless” in terms of its potential for oil and gas.

“Because it was worthless” in the 1970s, Davidson said. “But we thought someday, there might be something down there.”

So just to be on the safe side, Davidson said he and his partner put a “newfangled depth-limitation clause” in the plantation’s oil and gas lease, which prevented the developer from drilling down past the known area of hydrocarbons into the seemingly “worthless” Haynesville.

It proved to be a prophetic move. A few years ago, when producers finally tapped the Haynesville using horizontal drilling, hydraulic fracturing and other modern technologies, Davison said the landowners leased their deep mineral rights for a whopping $152 million — a payday they never would have received had their original, ’70s-era lease not included the depth-limitation clause.

“That’s how important [leasing terms] can get, because you never know what the next big thing is going to be,” Davidson said.

But some folks who own mineral rights in Pennsylvania’s section of the Marcellus Shale were not so lucky — despite being just a few years removed from the shale boom in their region. Dale Tice, a Pennsylvania attorney at Marshall, Parker & Associates, said oil and gas companies leased up huge tracts of land in the Marcellus in early 2000s, prior to the onset of horizontal drilling and fracking. And Tice said that many of those leases had very unfavorable terms for landowners, such as minimum-guaranteed royalty rates, and minimal cash bonus payments. Moreover, many of those leases locked the landowners into those terms for as long as 10 years, Tice said.

When the Marcellus shale boom began in earnest in about 2008, people started connecting the dots, Tice said.

“In hindsight, it’s pretty apparent that the oil and gas companies had a pretty good idea of what was coming down the pike before the landowners did,” he said. “That’s one of the unfortunate realities for a lot of landowners” in the Marcellus.

Tice said that in most cases, landowners that agreed to those unfavorable terms have “no legal recourse” to get out of their leases. But with gas prices now having plummeted because of the shale boom, few landowners would receive better offers, he said.

—Brian Hansen
'The nature of the business'

Dale Tice, a Pennsylvania attorney at Marshall, Parker & Associates who represents people who lease their mineral rights to Marcellus oil and gas drillers, said it’s not uncommon for landmen to pressure people into signing leases that are not in their best financial interests. For example, Tice said he’s heard of landmen telling property owners that they’re only going to be in town for another 24 hours, and that they’ve already signed up all of their neighbors, so they’d better take the offer that’s on the table.

"I don’t think it’s an exception," Tice said. "The landmen are clearly working for the gas company, and sometimes it seems that some of their behaviors are ethically questionable. But that’s kind of the nature of the business."

Tice said that these tactics often work because most landowners are “unsophisticated.”

“In some cases, [landmen] are dealing with elderly individuals who are essentially signing what they’re asked to sign,” he said.

For example, Tice said he’s currently representing a landowner who signed two different leases for the same mineral rights. Now, it’s not clear which lease is in effect, he said.

“It puts the landowner in a very touchy situation, because they did sign the leases, even though they really shouldn’t have,” he said. "But how can you expect an 80-year old woman to keep track of all this stuff? There's some horror stories like that hanging out there."

Randall Davidson, a landowner attorney at Davidson, Jones & Summers in Shreveport, Louisiana, voiced a similar view.

"There are good landmen and bad landmen, but the techniques that they use in the field on unsophisticated people are not good," he said.

But Davidson was quick to add that there are also "unscrupulous attorneys out there" who try to get people to sign undervalued or otherwise badly crafted leases that they then "flip to an oil company."

"So you've got unscrupulous people all over the place," he said. "They're not all on Wall Street; some of them are in the cotton fields down here."

Landman group: Ethics are paramount

The landman industry’s primary trade group, for its part, said it expects its 16,000-plus dues-paying members abide by its code of ethics and standards of practice, both of which call for landmen to treat mineral-rights owners with fairness, honesty and respect. Marty Schardt, the executive vice president of the Fort Worth, Texas-based American Association of Professional Landmen, said members who violate those standards can be expelled from the organization.

Schardt said his group has no authority to bring charges against rogue landmen, and he declined say how many members have been ousted from his organization.

“I actually don’t know that number, but I wouldn’t tell you if I did," he said. "That’s confidential to the association.”

AAPL offers three levels of "certification" for landmen, which
Schardt says allows landmen to "further their careers and be able to state that they’ve achieved a certain level of expertise." But he said there is no standardized exam that people have to pass to get a job as a landman in the US, as is the case in law, real estate and other professions.

"Getting a job is all based on a company's needs," he said. "But a company probably won’t hire you unless you have some experience."

AAPL allows mineral-rights owners to check to see if a landman who contacted them is a member in "good standing." Jeff Votaw, one of the two landmen who Debra Ganske says fraudulently induced her to lease her oil and gas rights in the Bakken, is listed as a member in good standing, with no complaints lodged against him, according to AAPL. The other landman that Ganske names in her lawsuit, Ric Henricksen, is not listed as being a member of AAPL. The same is true for Matthew Galey, the Cabot landman who Wayne and Mary Harrison say fraudulently induced them to lease their mineral rights in the Marcellus.

One of the US’ leading oil companies, for its part, said mineral-rights owners can stave off many potential leasing-related problems simply by opening an honest dialogue with the production firm. Jeff Hume of Continental Resources, the largest leaseholder in the Bakken, said leaseholders frequently ask for production on their land to be expedited so they can enjoy the full benefits of their royalties. Hume, Continental’s vice chairman of strategic growth initiatives, said his company and other firms honor those requests whenever possible.

"We’ve had many, many mineral-owner relationships where they’ve called and said, ‘Man, we’d really like to have an additional well drilled on us if you plan to drill one; my father’s 85 and he’s not going to live to see it. Can you do that?’ Hume said. ‘In most cases, oil companies try to accommodate people if they can.’

—Brian Hansen