



OIL & GAS LEASES IN NORTH CAROLINA: Summary of Landowner and Public Protections in the Law P.L. 2012-143 (S. 820) and S.L. 2011-276 (H. 242):

1. NOTICE AND ENTRY TO PROPERTY

A. Operations That Do Not Disturb the Surface:

A gas developer or operator must give the surface owner 14 days written notice by certified mail (which cannot be waived) before entering the property for operations that do not disturb the surface (i.e., inspections, surveys, staking, etc.). The notice must identify the person requesting entry; the purpose for entry; and the dates, times and location on which entry will occur, including the estimated number of entries. *G.S. § 113-420(a)*.

B. Operations That Disturb the Surface:

For operations that disturb the surface, the oil and gas developer or operator must give the surface owner 30 days written notice by certified mail (which cannot be waived). The notice must include at a minimum: (a) a description of the exploration or development plan, including the proposed locations of roads, drill pads, pipeline routes, and other alterations to the surface, and the proposed date on which the proposed alterations will begin; (b) an offer to consult with the surface owner to review and discuss the locations of the proposed alterations; and (c) the name, address, telephone number and title of a contact person employed by or representing the oil or gas developer or operator that the surface owner may contact to discuss the location of the proposed alterations. *G.S. § 113-420(b)*.

Failure to Comply. If a developer or operator fails to comply with these two provisions, the surface owner may seek relief in superior court where the well is to be located and receive actual damages. *G.S. § 113-420(c)*.

2. WATER SUPPLY AND WATER CONTAMINATION

A. Use of Water by the Operator and Compensation:

A gas lease must clearly state whether the operator will use water supplies located on the property. If so, the lease must estimate the amount of water to be withdrawn, and the operator must seek the permission of the surface owner before using water from the property. The operator may not restrict the landowner's water supply for domestic uses. Finally, the lease must provide for "full compensation" to the landowner for any water use by the operator "in an amount not less than the fair market value." *G.S. § 113-423(e)*.

B. Pre-Drilling Testing of Water Supplies:

All gas leases must include a clause requiring the operator to conduct a baseline test of all water supplies within 5,000 feet from a wellhead at least 30 days prior to drilling, and at least two follow-up tests within two years after production begins. The North Carolina Department of Environment and Natural Resources (DENR) must identify the location of all water supplies, including wells, on a property where drilling is to occur. A surface owner may elect to have DENR sample wells located on their property, instead of sampling by the operator, in which case the operator must reimburse DENR for the costs. *G.S. § 113-423(f)*.

C. Presumptive Liability for Water Contamination:

It is presumed that a gas operator is responsible for, or caused, contamination of all water supplies that are within 5,000 feet of the wellhead. To prove otherwise, an operator must prove one of the following: (i) the contamination existed prior to drilling; (ii) the landowner refused to allow the operator access to conduct a pre-drilling test; (iii) the water supply is not within 5,000 feet of the wellhead; or (iv) the contamination was a result of other factors and not due to the operator's activities. *G.S. § 113-421(a)(1)*.

D. Damages and Replacement of Water Supply Where Contamination Occurs:

If a water supply is contaminated, the operator is liable for damages, and must provide a replacement water supply to the surface owner and others using the water supply, and the water supply "must be adequate in quality and quantity for those persons' use." *G.S. § 113-421(a), (a4)*.

3. SURFACE ACTIVITIES AND COMPENSATION FOR DAMAGES

A. Reasonable Accommodation of Surface Uses:

A gas operator must accommodate the surface owner "by minimizing intrusion upon and damage to the surface of the land." As used in the Act, this means "selecting alternative locations for wells, roads, pipelines, or production facilities, or employing alternative means of operation that prevent, reduce, or mitigate the impacts of the oil and gas operations on the surface, where such alternatives are technologically sound, economically practicable, and reasonably available to the operator." *G.S. § 113-423.1(b)*.

If an operator fails to comply with this requirement, the landowner may bring an action for damages. *G.S. § 113-423.1(b)*.

B. Required Compensation for Damages:

An operator is obligated to pay the surface owner compensation for all of the following damages caused by the operator's activities:

- Damage to a prior water supply;
- The cost of repair of personal property “up to the value of replacement by personal property of like age, wear, and quality”; and
- Damage to any livestock, crops, or timber determined according to the market value of the resources destroyed, damaged, or prevented from reaching market. *G.S. §113-421(a1)*.

4. INDEMNIFICATION

If a neighboring landowner, or any other person, brings a lawsuit against a landowner in connection with the operator’s activities, the operator is responsible for all costs of defending the suit and for any resulting liability, as the operator must:

“indemnify and hold harmless a surface owner against *any claims* related to the ... operator's activities on the ... property, including, but not limited to, (i) claims of injury or death to any person; (ii) damage to impacted infrastructure or water supplies; (iii) damage to a third party's real or personal property; and (iv) violations of any federal, State, or local law, rule, regulation, or ordinance, including those for protection of the environment.” *G.S. § 113-422 (emphasis added)*.

5. RECLAMATION

- A. Reclamation Required. An operator is required to reclaim or restore all surface areas within two years following completion of operations. *G.S. § 113-421(a2)*.
- B. Reclamation Bond Required. Prior to beginning activities, the gas developer or operator must provide a bond to the surface owner sufficient to cover reclamation of the property. *G.S. § 113-421(a2)*.

6. ACTIONS FOR DAMAGES

- A. Actions to be Brought in Superior Court. Any action by the surface owner to recover damages or royalties in connection with the gas operations is to be brought in superior court where the property is located.
- B. Award of Attorneys’ Fees and Costs. If the surface owner wins an action to recover unpaid royalties or other damages, the court “shall award any court costs and reasonable attorneys' fees” to the surface owner or his or her assignee.
- C. Arbitration Clauses Prohibited. Conditions precedent, notice provisions, or arbitration clauses included in lease documents that have the effect of limiting access to the superior court where the well is located are “void and unenforceable.” *G.S. § 113-421(c)*.

7. LANDMAN REGISTRY

Gas leases are often offered by salesmen called landmen who research property titles and solicit landowners to sign leases, often going door-to-door. Some landmen work for oil and gas companies; some are employed by independent landman companies; and others are independent contractors.

- A. Creation of Registry. Any landman doing business in North Carolina is required by law to register with DENR, with is to establish and maintain a registry of landmen operating in the State. To check out a landman with DENR, visit <http://portal.ncdenr.org/web/lr/registry-of-landmen> or call 919-707-8605. *G.S. § 113-425(a), (b).*
- B. Denial or Suspension of Registration. DENR may deny registration to an applicant, reprimand a registrant, suspend or revoke a registration, or impose a civil penalty on a registrant if DENR finds that the applicant or registrant:
- Fraudulently or deceptively obtains, or attempts to obtain, a registration;
 - Uses or attempts to use an expired, suspended, or revoked registration;
 - Falsely claims to be a registered landman;
 - Engages in any other fraud, deception, misrepresentation, or knowing omission of material facts related to oil or gas interests;
 - Had a similar registration or license denied, suspended, or revoked in another state or jurisdiction; or
 - Engages in other violations of the section. *G.S. § 113-425(c).*

8. REQUIRED LEASE TERMS

A. Landowner Education Information Required to be Provided When a Lease is Offered:

At the time that a lease is offered, the developer, operator or other person offering the lease is required to provide the landowner with a publication on oil and gas leases and landowners' rights in North Carolina by the Attorney General's Consumer Protection Division and a copy of the part of state law that includes landowner and public protections (see Part V. of Session Law 2012-143 (S. 820), the Clean Energy and Economic Security Act, available online at www.ncleg.net). *G.S. §§ 113-423(a), 113-426.*

A copy of the publication from the Attorney General's Office, Oil & Gas Leases: Landowners' Rights, is also available online at www.ncdoj.gov.

B. Bonus Payments:

When a landowner signs a lease, they are often paid a lump sum amount called a bonus payment, which is typically paid per acre at the current market rate for the area. Bonus payments can vary dramatically depending on the amount of land leased, the market price of gas, whether there is established gas production in the area, whether competition exists for leases, and the knowledge and negotiating skill of the parties. Sometimes bonus payments are not made to the landowner when the lease is signed, but payment is instead deferred until the lessee –the party offering the lease – completes its title research and verifies the landowner’s ownership of the oil and gas rights.

Under North Carolina law:

- Bonus payments or any other initial payments must be paid to the landowner within 60 days of the execution of the lease. *G.S. § 113-423(d)*.
- If the bonus payment is not made within 60 days, the landowner is entitled to interest at the rate of 10% per year on the unpaid amount. *G.S. § 113-423(d)*.

C. Disclosure that the Landowner Should Obtain the Approval of their Mortgage Lender Before Signing:

The Act requires that all gas leases entered into after the Act’s effective date contain a conspicuous disclosure that a landowner should obtain the approval of his or her mortgage lender before signing the lease.

The lease must contain the following written disclosure, which must be in boldface type, and must be initialed by the landowner:

Surface owners are advised to secure written approval from any lender who holds a mortgage or deed of trust on any portion of the surface property involved in the lease prior to execution of the lease and obtain written confirmation that execution of the lease will not violate any provision associated with any applicable mortgage or deed of trust, which could potentially result in foreclosure.

D. Royalty Payments:

- Any oil or gas lease must provide for a royalty payment of at least 12.5% of the proceeds of sale. A number of other states, including Pennsylvania, also have statutory minimums of 12.5%.
- Prohibition of deductions for costs. Royalties “shall not be diminished by pre-production or post-production costs, fees, or other charges assessed by the oil or gas developer or operator against the property owner.”

- Royalty payments must be made no later than six months after the date of first sale, and afterwards, no later than 60 days after the end of the calendar quarter within which subsequent production is sold. *G.S. § 113-423(c)*.
- With each royalty payment, the landowner must be provided with documentation showing the time period for which the royalty payment is made, the quantity of product sold within that period, and the price received, at a minimum.
- If royalty payments are not made on time, the landowner is entitled to interest at the rate of 12.5% per year on the unpaid amounts.
- Upon written request, the landowner is entitled to inspect and copy records of the oil or gas developer or operator related to production and royalty payments associated with the lease. *G.S. § 113-423(c)*.

E. Right of Cancellation:

- After signing an oil or gas lease, either party to the lease may rescind or cancel the lease within seven business days by notifying the other party in writing. If any payments have been made, those amounts must be returned.
- All oil or gas leases must contain a “bold and conspicuous notice” of this right. *G.S. § 113-423(j); Session Law 2012-201 (H 953)*.

F. Maximum Duration of Lease:

- Any oil or gas lease is deemed to expire at the end of 10 years, unless oil or gas is being produced for commercial purposes from the leased property.
- If, at any time after the 10-year period, commercial production of oil or gas is terminated for a period of six months or more, the lease ends.
- Production includes “the actual production of oil or gas by a lessee, or when activities are being conducted by the lessee for injection, withdrawal, storage, or disposal of water, gas, or other fluids, or when rentals or royalties are being paid by the lessee.”
- Any *force majeure* clause (a clause related to extraordinary events such as war or natural disaster) in a lease will not extend the lease beyond these timeframes.
- Any assignment or agreement to waive these provisions is invalid and unenforceable. *G.S. § 113-423(b)*.

9. ADDITIONAL PROVISIONS

A. Recording of Leases:

All oil or gas leases, including any assignments of leases, must be recorded within 30 days of execution in the register of deeds office in the county where the land is located. *G.S. § 113-423(g)*.

B. Notice of Assignment Required:

If a lease is subsequently assigned or sold, the lessee must give written notice to the landowner within 30 days of the assignment. If there is a “split” estate, and the person entering into the lease is not the surface owner of the property, the lessee must notify the surface owner as well. *G.S. § 113-423(h)*.

C. Disclosure of the Severance of Oil or Gas Rights upon the Sale of Residential Property:

The Act amends the Residential Property Disclosure Act, *G.S. § 47E-1, et seq.*, to require that sellers of residential real estate conspicuously disclose to potential buyers if oil or gas rights are severed—which means that they would not own the oil and gas rights to the property they are buying. *G.S. § 47E-4(b2); § 113-426*.

Specifically, North Carolina law now requires all sellers, even builders and sellers of new construction, to disclose in the sales contract the status of oil and gas rights regarding any property offered for sale. The limited exceptions deal primarily with transfers of property pursuant to court order or the administration of an estate, sales between co-owners of the property, and lease with option to purchase contracts where the lessee occupies the dwelling. Notably, parties negotiating a real estate sale cannot waive this oil and gas rights disclosure even if they agree not to complete a residential property disclosure statement pursuant to N.C. Gen. Stat. Chapter 47E.

The mandatory language that must be included in boldface type in a real estate contract is set forth at N.C. Gen. Stat. § 47E-4(b2). The law requires the seller to answer three specific questions, and then obtain the buyer’s initials to acknowledge the oil and gas disclosure as part of the real estate contract. The seller must answer the following: (1) whether the oil and gas rights were severed from the property by a previous owner; (2) whether the seller has personally severed such rights from the property in the past; and, (3) whether the seller intends to sever the rights from the property prior to transfer of title to the potential buyer. All three questions must be answered “yes” or “no,” except that question (1) may be answered “no representation” by the seller.