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More Options Than They Realize

Mineral Owners Often Face Difficult Choices

Mineral owners are faced with what may seem like a gusher of choices when it comes time to turn their asset into income.

Like surface real estate, mineral estates are only as valuable as what someone will pay for them. Unfortunately, the hard value of a subsurface tract is often not fully understood by the owner.

For a surface property owner, even one only casually interested, finding current market value for a house and lot in Greeley is as simple as checking one of the dozen or so free online appraisal sites. Some real estate professionals might argue that those appraisals can be way off the mark or simply outdated by today's lightspeed market, but they still offer a reasonable snapshot of market value.

For the owner of a mineral estate, finding solid information on market value is difficult and can involve the purchase of a complicated software package or digging through gigabytes of public records.

Or, the owner can simply take the first offer the oil company landman lays on the table.

There is another way, says Adam Ferrari, who's namesake energy company occupies a niche in the oil and gas industry between the companies that drill the wells and the independent brokers of the rights to mineral assets.

"Many mineral owners don't understand that you do not have to take the oil company's lease offer," Ferrari said. "There are several options available, and it is important to understand the differences."

Ferrari is the CEO and managing partner at Ferrari Energy, a Denver-based company that concentrates on the DJ Basin, which includes Weld County. He is a former completions engineer at BP America who was assigned to projects in the Gulf and Onshore U.S. and later worked as an equity analyst at Macquarie Capital in Denver. He returned to oil and gas operations as an engineer at Halcon Resources before leaving to start up Ferrari Energy in August 2014

Ferrari said his company works as a non-operating oil company, meaning it acquires acreage positions in prospective development areas and participates in new well projects as owner of the rights to a portion of the mineral assets.

Non-op companies can share in the capital investments needed to drill a new well, which can run in millions, or not, depending on the company that assumes the mantle of operator or on the non-operator's interest in the project.

Over the century and a half that oil companies have been putting together deals to find and successfully draw out the viscous black liquid that powers our lives, the shape of those deals has gotten more layered and complex. In the end, however, an oil well gets drilled because someone has come up with the money to pay for it, which is still an expensive proposition even for the behemoths of the oil industry.

Ferrari said he understands how that complexity is needed to assure money is available to do all the things that need to be done and that the investors, whether it is capital investment or ownership, earn a predictable and economic return.

"Oil and gas agreements are complicated but most oil companies do a poor job of educating mineral owners about what is involved," Ferrari said. "The mineral asset has real value and there are many ways to monetize that value."

Ferrari Energy has grown to 44 employees in four years and participated in dozens of successful wells because "we bring top value to the mineral owner," Ferrari noted. "We do our homework and take the time to build relationships with the mineral owner. Our title work is second to none so we can produce ownership data with highest level of accuracy."

Ferrari said his company has access to capital and an understanding of the basin and its hotspots. As a result, when an oil company decides to move on a project as the operator, his company can agree to participate as the second largest stakeholder.

Risk Mitigation

"Making sound financial decisions is our core business," Ferrari stated. "We have the scale to assume a level of risk that might scare off an individual. And, we can hedge on price if we need to mitigate the downside that comes with every proposed development.

A wise investment banker from Omaha once said risk is mitigated by knowledge. In that case, the more a mineral owner knows, the easier it will be to make a good decision.

"Some owners see the appeal of sitting back and collecting royalty checks for years to come," Ferrari observed. "Others simply want to sell their minerals and cash out; that has plenty of appeal, too."

He advised that owners should consider the many options for monetizing their minerals. For example, selling them outright brings immediate income but has tax implications; accepting a lease offer from an operator may be simple and straightforward but might not produce the highest return; and a mineral owner has the right to participate as a non-operating owner in the well, which includes the downside of possibly being on the hook for the cost of additional wells drilled within a unit.

"I have seen instances where an investor decides to participate in a well and then gets hit with a joint interest bill for millions for another well already drilled in that unit," Ferrari said.

"Interest owner billing practices are held to very strict accounting standards but they are complex and difficult for the average person to understand, let alone contest," Ferrari said.

If it gets to that point, Ferrari noted, the operator will likely present a "take it or leave it" offer to assume a portion of the owner's position to let them off the hook for what they owe.

Ferrari said it takes plenty of accounting horsepower to challenge a questionable joint interest bill. "We have the leverage to call the company out," he said. "It doesn't happen often but if it does, we can respond."

Forced Pooling

Ferrari noted that Colorado mineral owners who choose not to sell, lease or otherwise participate in a well can find their mineral interests "forced pooled" with others in a drilling unit.

"We hear that a lot from mineral owners," Ferrari reported. "It's shocking that people, for their own political beliefs, decide not to sign a lease."

Where a typical lease might offer the mineral owner a 3⁄16th share, or 18.75 percent, of their portion of a well's net return, an owner who is forced into a unit usually gets only 1/8th, or 12 percent, he said.

"By making a decision not to sign, the mineral owner is losing money," Ferrari said. "My advice is that if your minerals are going to be developed; you might as well benefit from it"

The state's mineral owner rules were recently updated in the 2018 Colorado legislative session. Operators are now required to give mineral owners 60 days notice of the company's intent to seek formation of pooled interest in a drilling unit, increased from 35 days notice.

The new law also relieves non-consenting owners from possible liability for spills or other damages caused by a well.

Forcing owners into a drilling unit is unfortunate but a fair way to ensure all owners can enjoy their property, Ferrari said. "It's a necessary part of our law."

Asked what he would change about Colorado's oil and gas regulations if he could, Ferrari quickly replies he would revise the rules for how spacing units are sized. As the rules now stand, operators have too much leeway in determining how many acres are in a spacing unit.

"There is no consistency in how they are sized or approved," Ferrari said. "More uniformity would go a long way. We have situations where a mineral owner is in a unit with a single well while his neighbor with the same number of acres has three or four. As it is, units are being formed that are inconsistent with practical engineering and unfair to mineral owners."

Ferrari concluded "operators know they have the authority they need to drill their next well. So long as someone participating in a well has the lease, they really don't care if units are fair. Our job is to make sure our owners are getting the highest value."

"If the companies did a better job educating mineral owners," he said, "it would make it a lot tougher for us."