



Considerations Before Signing A Natural Gas Lease

Discovering you have the opportunity to lease the natural gas rights on your property can be an exciting time. Landowners will begin the complex process of working with gas companies, where they will find a great need for education, expertise, protection, and unbiased advice. The important thing to consider is not to rush. The first lease presented to you may not be the best lease for you and your family. Understanding the language of this legally-binding document and its future financial impact can be overwhelming. As early in the process as possible, preferably before signing a lease, it is recommended that landowners consider discussing their situation in detail with their attorney, financial advisor, and accountant. There are many options available to negotiate your lease; but often the more limitations you provide the gas company, the less payments you may receive. Please see the following for a few of the many considerations you should discuss before signing a natural gas lease. Please note that everyone's circumstance is different and some of these may not apply to your unique situation.

Do You Own The Resources Under Your Land?

The resources below your land may have already been leased, sold, or transferred prior to you purchasing the land. Local public records or your deed may indicate the status of your property rights. Further research may need to be done in order to clarify different ownership interests. Be aware that "mineral rights" and "gas rights" may not necessarily be the same thing.

Ensure Everything That Was Told To You Is Written In The Lease

The legally-binding lease governs nearly all aspects of the exploration and drilling on your land. Know that the written terms in the lease will supersede any verbal communications previously had between the landowner and the gas company, so it is important to thoroughly review to ensure everything promised to you is covered in detail within the lease.

How Long Is The Term Of The Lease?

Many leases will specify a primary term, usually five years, when gas companies must "begin" operations. If this term expires without activity from the gas company, leases may end at that time. More often, companies commence drilling during this period and the lease transitions into the secondary term, which typically lasts as long as there is production. Pay attention to the language used describing the length of any terms in your lease and the definition of commencement of operations. Similar wording may mean very different things as well as broad wording may leave things open-ended in favor of the gas company. For example, simply moving the gas company's equipment onto your land may be enough to continue the lease indefinitely, even if actual drilling has not yet occurred.

Who Is Liable If Something Goes Wrong?

Properly structuring a gas lease may help reduce unplanned liabilities. Who is responsible if there is an accident, major injury, or environmental damage? Confirm with the gas company (and your attorney) who is liable should certain incidents occur. Does the gas company provide liability insurance? If so, is it adequate? What situations does it cover and not cover?

What Happens Should The Lease Expire?

Should the initial term(s) of the lease expire, are you subject to renewal provisions? If so, are the provisions in favor of the gas company or the landowner? Some consider "right of first refusal" provisions to be preferable for the landowner because they give the gas company the right to match any competitor offers for renewing the lease at the end of the primary term, as opposed to making the renewal automatic. In addition, are there restrictions from receiving a new "bonus payment" from the same company should you renew?



Can The Lease Ever Be Canceled?

Typically, once a lease is signed, you are legally bound to the terms of that agreement. However, if the landowner can prove fraud with the lease signing process, the contract may be able to be voided or changed. Proving fraud in such a situation may be difficult, time consuming, and costly. Discuss with your attorney your options should the gas company not fulfill their end of the agreement after the lease is signed, such as changing the size of an up-front bonus payment.

Surface Rights & Should You Add Limitations?

Standard leases may give a very broad use of “surface rights” (access and use of your above-ground land) to give the gas company the greatest flexibility with operating, such as building roads for machinery, pipelines, worker parking, land grading for drilling pads, among other things. Based on your situation you may want to include limits or guidelines that give you greater control should certain situations arise. Opting to fully restrict surface rights is also an option, but this may limit the abilities of the gas company. You may also want to separately negotiate these rights to receive additional income.

Does The Lease Include Access To Everything Below Your Feet Or Just The “Layer” Being Drilled?

As the drilling technology advances, there may be more opportunities in future years for you or your family for new lease agreements. Aside from Marcellus Shale, other layers, such as the Utica Shale which lies below the Marcellus Shale, exist. It is important to know exactly what rights you are leasing and to consider keeping other layers separate.

What Different Types Of Compensation Does The Lease Provide?

Gas companies have a variety of ways to compensate the landowner. It is important to have a thorough understanding of exactly how you will be paid and what future payments you may receive as these can vary greatly depending on the lease. A few of the most common ones are discussed below. Please note these are general descriptions and payment structures may vary greatly lease to lease.

- *Bonus Payments:* Usually a one-time lump sum payment, received shortly after signing the lease
- *Rental Payments:* Often a lump sum, but can also be annually, based on the term of the lease
- *Delay Rental Payments:* Compensates the landowner for delays in drilling, often in addition to rental payments
- *Free Natural Gas:* Entitles the landowner to a specific amount of gas extracted from their property for use at no cost
- *Royalty Payments:* Based on a portion of the gas extracted, royalties may sizably decrease as your gas reserves deplete
 - Pennsylvania law requires royalties of no less than 12.5% of natural gas removed be paid to landowners
 - Be sure to understand your royalties’ formula, as it is likely your largest component of compensation
 - Understand if payments are before, or after, taking into account expenses incurred by the gas company
- *Other Revenue Opportunities:*
 - Discuss with your attorney the advantages to having separate leases for certain revenue sources
 - The need to build pipelines to transfer extracted gas could lead to income for the landowner
 - Storing supplies or excess gas could provide additional income for the landowner
 - Gas companies may sub-contract other companies who purchase/remove resources on your property that are necessary for the gas company to operate, such as stone, timber, or water access

Environmental Considerations

When making your important lease decisions, consider the environmental impact caused by the drilling activity on your land. Should there be extensive damage or removal of soil, trees, stone, etc.; how will this be restored after drilling has commenced? How far from local water supplies and family homes will drilling be conducted? Is the gas company required to regularly test drinking water to ensure it has not been contaminated? How and where does the gas company dispose of the water used for the drilling process? Work with your attorney to ensure your lease is clear about post-drilling cleanup and land restoration.



Additional Questions To Ask

- If the gas company is drilling on a small part of a multi-family drilling unit, does this “lock-up” the remaining land?
- Can you compare local lease offers? How do you know if you are being adequately compensated for your gas rights?
- Do you fully understand how each type of lease income is taxed and how it will affect your finances going forward?
- Are there planning opportunities available that will help reduce taxes and/or transfer income to family members?
- Where do landowners find the professionals they need to help with the complexities of the gas leasing process?

Final Thoughts

The discovery of the Marcellus Shale has led to a rush of new landowners signing leases. This article discusses just a few of the many considerations you must think about. If you have the opportunity to lease your natural gas rights, before signing any lease we recommend you discuss your options with a qualified attorney, accountant, and your Hefren-Tillotson financial advisor to ensure you are protecting yourself and family from unnecessary risk and to ensure you are adequately compensated for your gas rights.

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