

Before you Sign that Oil or Gas Lease
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It almost seems like free money: someone offers you \$70 an acre for an oil and gas lease and, if they ever find anything, you get free gas and a royalty. “We’ve always signed the leases,” one dairy farmer explained recently. “My father did, and we did too, not giving too much thought to it. But I sure would do things differently knowing then what I know now.”

This seems to be the consensus of most folks who’ve signed oil and gas leases. “We don’t want to keep them from finding the gas,” one landowner said. “In this age of ever-rising energy prices, we are more than willing to allow the companies an opportunity to find the oil and gas that we need.” But the landowners want a fair deal.

With the new interest in pockets of natural gas trapped in the Trenton/Black River deposits – deposits located a mile to 10,000 feet below the surface – the exploration and drilling has taken on a new, much larger, dimension. More landmen are combing the back roads, trying to get landowners to sign their pre-printed leases. In exchange, they offer a few bucks an acre rental for each year the lease is in effect, a chunk of change for a signing bonus, and a royalty of 12.5 percent.

“Before you sign on the dotted line, you’d better make sure you know what you’re signing away,” says Ashur Terwilliger, president of Chemung County Farm Bureau. “Texas landowners get 20 to 25 percent royalties, and up to \$250 an acre per year,” he explains. Meanwhile landowners in New York are often told that 12.5 percent is the standard royalty. While 12.5 percent is the amount set by New York State as the minimum royalty due landowners, there is no state law saying that is the only royalty that can be paid. Within the past year, Chemung County put nearly 4,000 acres of county land up for bid for natural gas leases. They also put the royalty rates out for bid and were rewarded with an offer of 18.75 percent.

“We will never offer that to a landowner,” a landsman told this reporter. But they are willing to negotiate the signing bonus, and often return to landowners with a higher offer. The money often distracts a landowner’s attention from this central fact: oil and gas are valuable commodities and worth millions to the company that eventually extracts them.

Things to consider before signing a lease

Because leases are legal and binding documents, it is important to consider a number of things before signing your name. “Our biggest concern is maintaining the farm as it is currently operated,” says Martha Goodsell. Goodsell raises fallow deer, rotating her herd from one pasture to the next in a rotational grazing plan. Fences and gates are important to her operation.

“We added a clause requiring them (exploration and/or drilling crews) to use only existing

roads, and not drive on the pastures. We also stipulated that we be present to unlock and lock gates,” she explained. To protect her livestock, she added language that requires the energy company to build fences around any drilling area. In addition, the contract with the seismic crew requires them to mark with paint rather than surveyor’s tape or flags, as deer will eat the tape.

“If I had to do it over again, I would include something about biosecurity,” she adds. She is concerned about foreign pathogens that could be transferred to her herd via soil on the treads of the machinery.

This is not a frivolous concern, notes John Lacey. Uninvited guests, such as the golden nematode, can travel from one parcel of land to another, tucked in the treads of the excavation machinery. The golden nematode infects the roots of potatoes and tomatoes, resulting in a huge loss of income to farmers depending on those cash crops.

Land Disturbance

Lacey, formerly with Ag and Markets Division of Agricultural Protection and Development, is now a consultant and has his own checklist for landowners who are thinking about signing a lease. “Wells can easily disturb an area of three acres or more, just for the well pad and the drilling operation,” he explains. Any serious operation will need a heavy duty access road, and then there’s the pipeline to carry the gas to the gathering line. While the actual drilling of a well is a temporary activity, it may have lasting affect on your land.

“You need to look at a complete picture of your soils, the drainage, the contours, the soil types, everything.” Lacey emphasizes that the landowner must know what all his land resources are: what is the topography, the terrain? Where are the wet areas and woodlands?

“Landowners need to think in terms of locations that may be affected by exploration,” he says. In upstate New York drainage is an issue because of the fragipan below the surface. Excavation cuts into the layers, and water will emerge, gathering in one location and perhaps contributing to erosion. So you may need to consider perimeter drainage.

Soil compaction is also a big concern, as is reduction of fertility caused by the mixing of soil layers. “You also want your soil returned to as natural a state as it can be,” Lacey notes. With the compaction caused by heavy machinery, this may require deep tillage of the subsoil, before returning the topsoil and restoring the contours.

But even if you write these things into your lease, you need to stay on top of the project, warns Lacey. You need to walk out to look over the work, and document problems with a camera. Landowners can get good advice on restoration and construction projects from guidelines published by the Dept. of Ag and Markets.

Crop losses and property damage

Liza White and Andy Leed grow mixed vegetables and certified seed potatoes on their organic farm. To protect their farm and livelihood, they have some additional clauses they want added to

any lease they sign. In addition to deep tillage and restoring soil, they want to protect their ponds that provide irrigation water for their crops. They have also included language that requires payment for damage to field crops and timber.

“We have some language about replacing fences as well,” White notes – though in their case it is a matter of keeping deer *out*.

“We need to think beyond the current crop,” notes one dairy farmer. He has been approached by a company interested in placing a well pad on his land. “They’ll need a pipeline and are offering \$4/foot.” But to put in a pipeline, they will need to clear a swath about 70 to 80 feet wide, mowing down corn, alfalfa, and even timber. The loss in crops and timber far outweighs the meager \$4/foot payment. This farmer wants to consider the price his timber, if mature, will bring as well as the loss of feed to his cattle.

“This is all I own,” he says. “This land is my retirement, and I need to consider, too, whether having a pipeline through it diminishes the property value.” Still, he admits that there might be some positive aspects. Perhaps the energy company will build a better access road to some back acreage. This farmer thinks both he and the company should benefit from the exploration.

Before the drilling can begin, before the well pads and pipelines can be put in, a seismic crew gathers information about what might lie below the surface. They do this by sending sound waves into the earth and then recording the reflected signals. This might mean drilling a hole and setting off a blast. Due to the depth of the Trenton/Black River formation, the holes drilled for seismic charges are deep, often 30 feet deep. Landowners, concerned about foundations and wells, may want to restrict this sort of seismic activity to a distance of no closer than 600 – 1000 feet from structures.

Another option is to request “no energy” seismic exploration, allowing only geophones – the listening devices – and cables on your property. “I thought that was the agreement I had,” said one landowner. But when he read the document he’d signed, he realized it did not include those restrictions. “You’ve got to read and re-read your lease,” he advises.

Limiting what’s tied up

News that folks in a neighboring town are receiving monthly royalty checks of \$1,000 or more fuels dreams of riches. The reality is that even if an energy company does find a deposit and dig a well, they may include only a small portion of your acreage in a drilling unit. One landowner received notification that a fraction of an acre of his land was included in a drilling unit. His lease was due to expire in another year, but now the rest of his land, nearly 400 acres, is tied up in this lease until the well has finished production.

To avoid this, add a clause that releases “any land not included in a drilling unit” at the end of the primary term of the lease. This “Pugh” clause allows a landowner the right to renegotiate future leases on lands not included in a drilling unit – as long as no other exploration work is occurring on that land. The energy company may be able to hold those acres in the lease by continuing seismic work, by drilling, or by something as simple as offering additional rental

payments: once you cash the check, you've effectively renewed your lease.

Landowners may also lease exploration rights to specific formations. For example, you might write in language that says you retain the mineral rights in formations above and below the target depth, and then name the formation that is being explored. This is called "horizontal severance".

One thing almost everyone who has signed a lease agrees on: if they could strike out the storage clause, they would. Allowing a company to store things on your property extends the lease indefinitely, and that is an encumbrance on your land. And like any other clause in a lease, you may negotiate to strike this out.

What if you *don't* sign a lease?

If oil or gas *is* found beneath your land, even if you don't have a lease, you will receive compensation for the resources that are extracted. New legislation assures that all landowners who have property in a drilling unit will receive compensation proportional to the amount of property they have in the unit. Through a process called "compulsory integration", landowners may either receive the base royalty of 12.5 percent, or they may choose to become either a participating or non-participating partner. Each choice carries its own risks and benefits.

Christopher Denton, an Elmira attorney specializing in oil and gas law, explains the choices this way: A landowner might elect to do nothing. In that case he would be integrated as a "royalty owner" and receive a royalty of 12.5 percent for the resources extracted from beneath his property. This is the same royalty most leaseholders are receiving. There is no risk in this choice, so if the energy company drills a dry hole, the landowner loses nothing.

A landowner may choose "Integration as a Participating Owner". Under this option the landowner must pay his share of the estimated well costs, money that is not refunded if the well is a dry hole or does not pay for itself. Rather than a royalty, you receive your full share of the production. If you have a one percent partnership in the well, you pay one percent of the costs and reap one percent of the rewards.

Those preferring a middle ground might pursue the option of "Integration as a Non-Participating Owner". Landowners electing this option have the same responsibilities as a participating owner, but don't pay the money up front. Instead, once the well is producing they pay a "risk penalty" of 200 percent, plus their share of the costs (for a total of 300 percent) before they see any revenue from the well. Once these costs are recovered, the non-participating owners receive their full share of production.

After walking through some examples, Denton makes it clear that compulsory integration was not the "worst case scenario" many landowners would have you believe it is. "The energy company wants to make a profit," Denton explains. "And you have the mineral resources. Before you make a decision, do the math."

Resources for Landowners

Rusty Keeler, of Spencer NY, recently started a landowner discussion forum dedicated to sharing information. To get on the forum send a blank e-mail to <*CitizensEnergyAlliance-subscribe@yahoogroups.com*>

Gas Exploration and Leasing on Private Land: Tips and Guidance for Landowners , from Cornell Cooperative Extension <<http://scnyat.cce.cornell.edu/gas/SCNY-CCE-gas-information-sheet.pdf>> or call (607) 535-7161 for a copy.

Checklists for Landowners available on <www.michiganfarmbureau.com/specials/oil-gas-mineral.pdf> and <www.tlma.org/oilgasleasechecklist.pdf>

Construction Projects Affecting Farmland, guidelines from NYS Dept. of Ag and Markets, <www.agmkt.state.ny.us/AP/agservices/construct.html>. To request a copy call (585)658-9854.