

PENNSYLVANIA STATE



The Dickinson
School of Law

Agricultural Law Resource and Reference Center
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MARCELLUS SHALE IN YOUR PRESENT AND FUTURE:

Legal Issues for Landowners

A fountain pen with a silver nib and a black barrel with silver rings is shown writing on a document. The document has some faint, illegible text and a signature. The background is a blurred image of a document with text.



- **The Agricultural Law Resource and Reference Center** is a collaboration between:
 - Penn State Law
 - Pennsylvania Department of Agriculture
 - Penn State College of Agricultural Sciences





The Leasing Process

- Energy company presents landowner with STANDARD lease agreement.
- Landowner negotiates additional terms to be included as addenda to lease agreement.
- Lease agreement will govern nearly all aspects of relationship between landowner and energy company.



Terms of Lease Agreement

- Parties to lease agreement
- Property description
- Length of lease agreement
- Payment terms
- Rights granted by landowner to energy company & limitations on those rights



Parties to Lease Agreement

- **Lessor – Owner of natural gas rights**
- **Lessee**
 - Lessee could be an independent landman, an energy company, a drilling company, or other.
 - Lessee will change if lease agreement is later assigned.



Property Description

- **Property will be described by one or more of the following:**
 - **County and township**
 - **Metes and bounds**
 - **Acreage**
 - **Tax assessment parcel number**
 - **Neighboring properties**



Length of Lease Agreement

- **Primary term**
 - **Primary term is the number of years defined in lease agreement.**
 - **Lease agreement ends if production activities do not begin by expiration of primary term.**
 - **If production activities begin, lease agreement is converted to secondary term.**



Extension of Primary Term

- **Renewal at option of lessee**
 - **Terms of current lease agreement will continue.**
- **Right of first refusal**
 - **Lessee has opportunity to match contract offers from other companies.**



Length of Lease Agreement

- **Secondary term**
 - **Secondary term begins upon the initiation of production activities.**
 - **Subject to the specific provisions in lease agreement, secondary term can extend far into the future.**



Payment Terms

- **Bonus Payment**
 - This is a one-time payment to landowner.
 - It is paid at execution of lease agreement or within a short time thereafter.
 - The amount is negotiable.



Payment Terms (continued)

- **Delay Rental Payments**
 - These are payments to landowner at times specified in lease agreement.
 - The obligation to make scheduled payments terminates when a well is drilled.
 - The amount and number of payments is negotiable.



Payment Terms (continued)

- **Royalty Payments**
 - These are paid to landowner when natural gas is removed from the land.
 - Pennsylvania law requires that landowner be paid royalties of at least 1/8.
 - Landowner can negotiate for a higher royalty rate.



Payment Terms (continued)

- **Shut-In Royalty Payments**
 - These are payments made to landowner when a well is drilled, but gas is not yet marketed.
 - The amount and circumstances under which payments are made is negotiable.



Payment Terms (continued)

- **Free Natural Gas**
 - Lease agreement may provide for landowner to receive a specified amount of extracted natural gas at no cost.
 - Landowner is generally responsible for transportation of gas from wellhead to residence.
 - Landowner can negotiate to receive a payment in lieu of free natural gas.



Rights Granted by Landowner

- **Mineral Estate**
- **Surface Estate**



Mineral Estate

- Lease agreement will specify what products within mineral estate are subject to grant.



Surface Estate

- **Energy company will seek broad use of surface estate.**
- **Landowner may want to limit energy company's use of surface estate.**



Surface Estate Limitations

- **Landowner may limit use of surface estate by:**
 - **Requiring that landowner approve well sites and access roads**
 - **Specifying the conditions under which the land will be reclaimed**
 - **Defining the permitted activities and structures**
 - **Requiring the installation of fencing or gates**



No Surface Rights Lease

- Landowner may be able to negotiate lease agreement that does not permit use of surface estate.
- Landowner may or may not receive lower payment terms in exchange for a no surface rights lease.



Property Damage Provisions

- **Lease agreement should address potential damage to:**
 - soils, crops, trees, buildings, roads, water, etc.
- **Lease agreement should provide method of valuing damages.**
- **Landowner should consider inclusion of arbitration clause.**



Indemnification Provisions

- **Landowner should require indemnity provision in lease agreement.**
- **Indemnity provision should include all costs of litigation.**
- **Indemnity provision should encompass environmental harms.**



Farmland Preservation Provisions

- **Participation in Clean and Green or other farmland preservation program may limit drilling activities or result in imposition of penalties.**
- **Landowner should seek to shift all potential financial liabilities to lessee.**



Storage Rights

- **Landowner should avoid granting storage rights in lease agreement.**
- **The grant of storage rights can effectively extend the lease term.**
- **The grant of storage rights should be separately negotiated for additional compensation.**



Transportation of Foreign Gas

- **Landowner should avoid granting transportation rights (installation of pipelines) in lease agreement.**
- **The grant of transportation rights should be separately negotiated for additional compensation.**



Additional Considerations

- **Well siting fee can provide additional compensation for land upon which well is located.**
- **Horizontal severance clause can limit gas development to a specific strata.**



Additional Considerations

- **Inclusion of Pugh Clause can prevent one well from tying up entire acreage.**
- **Pugh Clause can release land vertically or horizontally.**



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