Legal Brief

Tapping Into the Marcellus Shale Gas Boom

The next gold rush is well under way in Pennsylvania. An estimated 500 trillion cubic feet of natural gas is located in the Marcellus Shale formation and securing the rights to it has become a major priority of the gas industry. Producers already have invested $4 billion in Pennsylvania, much of it to secure the rights to subsurface minerals.

If your company, or you personally, own land in Pennsylvania, you may be thinking about how you can participate in this bonanza. However, many landowners are entering into agreements to lease their mineral rights without considering the long-term impact of their decision. Every piece of land is unique and presents different issues that should be considered before entering into a long-term oil and gas lease. The lease will control the rights and obligations of the landowner and the gas company for the duration of the contract. It is important to review the terms and conditions of a lease thoroughly before entering into any agreement. It is also important to consider what characteristics of the land are important to the landowner.

Lease Duration and Royalties

Two important issues in oil and gas leases involve the duration of the lease and how royalties will be calculated and paid. Gas leases are comprised of a primary and secondary term. The provision relating to the primary term allows the gas company to hold the land before any production occurs. This is for a fixed period of time, and the landowner can negotiate its duration and value. The upfront royalty payment is usually based on a fixed amount per acre of land during the primary term with a bonus offered for the first year's payment. Many landowners will want to negotiate for a shorter primary term to encourage the gas company to develop wells on their land more quickly.

The lease will define certain acts that automatically transition the lease from the primary term into the secondary term. Most landowners envision the secondary term beginning when a producing well is put in operation and they begin receiving royalty payments. However, many other acts included in the standard lease, ranging from drilling of a test well to the underground storage of gas, allow the gas company to enter the secondary term without producing gas that would result in royalties. It is in the landowner's interest to negotiate and fully understand what activities can activate the lease's secondary term. Most conditions that begin the secondary term also will be sufficient to continue the term of the lease. The lease term will not expire until the conditions no longer exist, even if no royalty producing activities are occurring.

Surface Development Considerations

Landowners also should negotiate the scope and nature of surface development. Drilling a well can take weeks to months to accomplish and is a water intensive activity during that time. The site where a well is going to be placed must be cleared, and roadways must be built or reinforced to handle the sudden influx of heavy equipment. A lease should cover the acceptable distance of well installations to prior existing buildings, allocate the payment for potential damages to agricultural crops and timber, and determine where roadways can be built. The use of water and protection of existing wells also should be negotiated.

Worth Noting

The goals and motivations of companies purchasing lease rights vary greatly. Some companies have the resources to purchase and develop prime areas of exploration while others operate by purchasing the lease rights of landowners as an investment to later sell when demand is higher. Landowners should know the reputation of the companies they are dealing with and should recognize that any lease may be sold or transferred to another company for development.

Entering into a gas lease can be a very lucrative decision, but it also can present complex issues for the landowner. The advice of a competent attorney should be sought out before any contract is signed.

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