

# Legal Brief



## Understanding and Benefiting From Pennsylvania's Natural Gas Boom

Pennsylvania continues to experience an increasing amount of natural gas drilling activity. As the focus of these efforts shifts from the Marcellus Shale to other shale formations such as the Utica Shale, areas of Pennsylvania that missed out on the Marcellus gas boom, such as the northwest part of the state, are now receiving increasing attention from drillers. This increased natural gas drilling activity presents opportunities and challenges to landowners, business owners and those who want to efficiently pass assets related to oil and gas drilling to future generations. This article summarizes some of the legal issues faced by each of these groups.

### Landowner Issues

Oil and gas leases are complicated binding contracts that use terminology unique to this industry. Signing an oil and gas lease can involve issues ranging from income taxes related to the upfront bonus payment and periodic royalty payments to environmental issues, such as water quality and erosion control, and real estate property taxes related to programs such as the Clean and Green Program. These issues can become more complicated if one person owns the mineral rights and a separate person owns the surface rights.

### Considerations for Business Owners

The shale gas and deep conventional wells currently being drilled comprise industrial operations covering several acres in size. These wells offer businesses opportunities to sign contracts for activities

involving the sale of steel, concrete and other equipment; disposal of water; and other matters. Because of their complexity, however, these business opportunities come with a substantial amount of risk.

Therefore, businesses that sign contracts covering goods and services provided at natural gas well drilling sites should carefully review provisions that limit liability, create warranties and require one party to indemnify the other in the event of loss. Although many people consider these provisions to be the "boiler plate" in a contract, they could have serious consequences if they are not drafted properly or if the party signing the contract does not understand what they mean.

### Estate Planning Considerations

Because shale gas leases can provide for bonus payments of several thousand dollars per acre and a substantial stream of royalty payments once production begins, at least in the early years of the well, owners of mineral rights can experience a substantial increase in income. As with any situation that generates wealth, passing that wealth onto future generations creates potential gift tax and estate tax issues.

With proper planning, these tax issues can be minimized, or at least planned for, so that the resulting tax liability does not create a financial hardship for the family. In some situations, it makes sense to create a limited liability company to hold the mineral rights so that they can be distributed and effectively managed.

Likewise, mineral rights can be gifted to future generations of family members in ways that reduce taxation. Alternatively, older family members can use the proceeds of royalty payments to pay college expenses of grandchildren as well as nieces and nephews in order to share the benefits of the natural gas found underneath their property.

### Conclusion

The situation confronting each family or business will be different. Therefore, it is important to discuss your particular situation with an experienced professional who can address each of the unique legal and financial situations involved. Addressing the risks ahead of time can eliminate surprises and reduce the resulting tax burden.

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