

# Tioga Landowners News

Hometown News for Landowners in Tioga County, NY  
www.tiogagaslease.org

Second Edition

Monday, September 22, 2008

## Opening Remarks

Welcome to the second edition of our newsletter. The Tioga County Landowners Group has been formed to join landowners in Tioga County together to obtain the best possible gas lease compatible with our ownership goals. We seek to be a strong organization dedicated to community education and an open information exchange. We will strive to be a resource to help further educate landowners about the impacts of gas leasing and drilling so landowners can make wise decisions about their property. We are dedicated to helping friends and neighbors to learn what is happening in the natural gas leaseholds here and around the country. We plan to collect and report news which is published and in public domain. In last months newsletter we reported on some recent history of leasing activities in other parts of the country. These are presented as a way to understand the evolution of leasing in other plays. This month let's talk about the activities in our own area and the factors at work which affects our play in Tioga County.

## News Affecting Tioga County

Over the past month we have seen a decline in landsman activities. Though still active they are fewer in number and giving a message of \$1000 per acre and 13.5%. This is

a direct result of the impact assessment underway at DEC. In July when Governor Patterson signed the Uniform Well Spacing Bill he directed DEC to perform a full impact assessment on the environmental issues created by horizontal drilling in Marcellus Shale. This assessment will take considerable time to accomplish probably until late spring 2009. Until that time DEC is not to approve any drilling permits for horizontal drilling as it gears up for a comprehensive public review of the industry's impact on the environment. This lull should only be temporary and will allow other companies to enter this play.

On the brighter side, five out-of-state companies, including Exxon Mobile, bid up to \$5,837 per acre for the right to take gas from under state land in northern Pennsylvania. The bids on 74,000 acres will produce \$190 million in revenue with the potential of hundreds of millions more in royalties. The 10-year leases include annual per-acre rental fees starting in the second year, the sale price counts as the first year's payment, with a 16 percent state royalty on natural-gas production. Continued price growth should occur in Pennsylvania while we are in this lull. Also expect to see Exxon Mobile in our play along with Chesapeake, Fortuna, Range Resources, and others.

Did anyone see where Chesapeake on September 5<sup>th</sup> sold some of their Fayetteville lease rights to BP a total of 135,000 acres for \$1.9 billion which works out to be

about \$14,000 per acre. And, while it was hard to tell from the brief news clip, it appears Chesapeake keeps 25% of the production. So Chesapeake flipped leases which they signed up for probably a few hundred dollars to BP for \$14,000 per acre and gets to keep 25% share royalty. Wouldn't it be nice to get a percentage of the gas companies profit if your lease was flipped? Chesapeake has said they will be raising Five Billion Dollars by flipping leases for Marcellus development.

## Group News

The group has been working to complete our landowner survey, with our rapid growth it has been difficult to complete the process. We will extend the survey thru the end of September so please go to our link and fill out the form. Speaking of growth, at last months meeting on August 12<sup>th</sup> we had 275 families and 13,000 acres in our group. Today, we have 400 families and 30,000 acres and we are still growing.

We are working to complete the attorney selection process. We hope to be able to make an announcement by months end. Then we will start, with our attorney, to understand **your** concerns and desires to be incorporated in the base lease document. Please continue to educate yourself thru the website and our workshops. We have been considering having Educational Workshops in other parts of Tioga



County. Email me with your thoughts and comments [www.tiogagaslease@aol.com](mailto:www.tiogagaslease@aol.com).

## What are Royalties?

A royalty is a percentage share of production, or the value derived from production, paid from a producing well. It is important to specify how royalties are to be calculated and paid as well as insuring that you are given the right to have a third party auditor verify the records of the production from your wells. Your royalty should be free of the costs of drilling and producing.

The signing bonus, which represents a substantial amount of money, is just the tip of the iceberg the real money is in the royalties. That is why the gas companies working this play have been offering very low royalty percentages like 12.5% which is the NY minimum by law. Let's build a few examples to see what your royalties might look like and what additional percentage points mean to **your income**.

To do the calculation we need to make some assumptions:

- How many of your acres are in the production unit
- Total Unit Acres
- Royalty %
- Gas Price per Mcf<sup>1</sup>
- Wellhead Production in MMcf<sup>2</sup>

For our calculation we assumed you have 50 acres in a 640 acre

<sup>1</sup> Per thousand cubic feet

<sup>2</sup> Million cubic feet of natural gas

production unit which is the largest allowed by DEC. If you have less acres divide the number or if you have more multiply. The average gas price year to date is \$8.73 which of course will change with market conditions. In last months news letter we reported that Range Resources on July 14 upped their estimate for the average Marcellus Horizontal Well to 4.1 MMcf per day (based on data from 20 wells) so let's use that figure. The following Table 1 is how the numbers work out.

Percent	12.5%	15%	20%	25%
Total Daily Production	\$35,793	\$35,793	\$35,793	\$35,793
Your Share of Pool	.07813	.07813	.07813	.07813
Your Daily Income	\$350	\$419	\$559	\$699
Your Weekly Income	\$2,447	\$2,936	\$3,915	\$4,894
Your Monthly Income	\$10,277	\$12,332	\$16,442	\$20,553
Your 1 <sup>st</sup> Year Income	\$127,233	\$152,680	\$203,573	\$254,466
Your Income 15 years	\$1,272,329	\$1,526,795	\$2,035,727	\$2,544,659

This is the largest opportunity of your lifetime and that is why we have said the real money is in the royalties. The gas company lease would sign you up for 12.5 to 15% in a lease with terms that are not in your best interest. We intend to push for the highest royalty we can obtain. The values for this table were produced by the Royalty Calculator on our website link. Go to the Royalties Tab and to the calculator to enter your own assumptions. The well 15 year life time total does allow for an expected drop off in production after the first year. With good investment you are creating a legacy for you and your heirs.

From this data it becomes increasingly clear that early next year we will need Educational Workshops on Financial Management and Estate Planning.

Hopefully next month's workshop we can have a presentation on drilling operations and options. Then perhaps we should start to discuss lease term descriptions and their value to each of us.

## The Big Picture

We are working to become part of a production unit in order to increase our income. That will improve the quality of life for us all, providing we do a good job

with the terms and conditions of our lease. The lease which you sign with the energy company is the legally binding document which will govern the business arrangement and actions of your business partner. Yes, your business partner for he will be with you for up to forty years so you will need to seek a fair and equitable relationship.

In order for drilling to occur there has to be a drill site, an access road, and a connecting pipeline. All carefully specified and agreed upon with your business partner as defined in our base lease. You will need to understand and think through the main issues which are most important to you and your family.

By working closely together we are helping to protect our community as we protect our



personal property. We care about our neighborhood and our community and want to maintain the best quality of life for our families. We each need to talk with our neighbors to educate them on the issues which impact us all. The water in the aquifer is a shared resource with your neighbors and represents one of the largest concerns of the group. Water usage and depletion or pollution of your drinking water is the major concern to all.

After our base lease is completed, and when we as a group decide to go to bid, we will need to sort out and contact as many energy companies that actually drill wells as we can. The end result of our efforts is to have a well drilled on your property. Dealing with a company that is not pulling drilling permits usually means they will flip your lease to one that will, and pick up a nice profit. Why deal with a middleman?

The amount of dollars a gas company will offer is based on many factors. Areas that are unproven or geologically less desirable will command less of a price. As the play matures, meaning “time marches on”, the characteristics and production potential of geographical areas will increase and risk will decrease, so rental rates will trend up. Our group has joined together for increased bargaining power to obtain the best money for each landowner because our bid will average out the good and the not so sweet spots for the benefit of all.

If they contact you to have a well drilled, great! You are now a royalty owner. With only a few dozen drilling rigs in NY, there is a probability that our land may not be drilled during the primary term

of our base lease. That means that we will have an opportunity to market our leases again. The other good news is that as the play matures, the price per acre should continue to go up. So when we re-negotiate your next lease, it could be much higher than those you see today. That would be good news for those who have not gotten a royalty income. Most of all, look at this play in the scope of the long term, not one isolated event with no future considerations.

### **Talk About Lease Terms**

The main "deal terms" of a lease are typically:

- Bonus,
- Primary term,
- Royalty clause
- Delay rental (if any)
- Shut-in clause

These are the main items to be considered in our base lease. Let's first explore each of these terms.

#### **Bonus**

The amount of money you are entitled to receive within a certain period of time upon signing a lease. The payment method is specified in the lease agreement. The safest way to receive payment maybe a paid up bonus. That is, the entire amount due over the entire term of the Primary Lease is paid up front. This eliminates the chance that the company “pulls out” 2 years down the road and still owes you the balance. However the paid up bonus has the largest tax impact, understanding the financial health of your business partner is very important consideration.

#### **Primary Term**

The period of time during which an oil and gas lease will be in effect, in the absence of production, drilling or other operations specified by the lease. The oil and gas lease can be perpetuated past the primary term by production in paying quantities, drilling, operations and/or the payment of shut-in royalties specified by the lease.

#### **Royalty Clause**

A percentage share of production, or the value derived from production, paid from a producing well. It is important to specify how royalties are to be calculated and paid as well as insuring that you are given the right to have a third party auditor verify the records of the production from your wells. Your royalty should be free of the costs of drilling and producing.

Prohibit or limit deductions of post-production costs – transportation, dehydration, compression, treating and marketing costs. Provide that royalties are based on the higher of market value or gross proceeds received by lessee at the point of sale, not net proceeds at the well. Address the sale of production to affiliates of the lessee. If there is an affiliate sale, the royalty should be based on the higher of gross proceeds or market value at the point of sale.

Detail the time, place and frequency of payment of royalties. Provide for interest on royalties not paid when due, at an above-market interest rate. Include the right to terminate the lease for failure to pay royalties, after a



period of written notice and opportunity to cure.

### **Delay Rental**

Consideration paid to the lessor by a lessee to extend the terms of an oil and gas lease in the absence of operations and/or production that is contractually required to hold the lease. This consideration is usually required to be paid on or before the anniversary date of the oil and gas lease during its primary term, and typically extends the lease for an additional year. Nonpayment of the delay rental in the absence of production or commencement of operations will generally result in abandonment of the lease after its primary term has expired.

### **Shut-in Clause**

A payment stipulated in the oil and gas lease, which royalty owners receive in lieu of actual production, when a gas well is shut-in due to lack of a suitable market, a lack of facilities to produce the product, or other cases defined within the shut-in provisions contained in the oil and gas lease. It is the responsibility of the landowner to clearly establish the allowable time limits for a well to be shut in.

These terms form the fundamental understanding of the base lease. There are many other terms to consider which will be topics of future News Letters and Educational Workshops.

### **Editors Comments**

The previous articles are intended to provide a status of activities in our area and our group. The

royalties discussion helps us to understand the real money trail in the Marcellus play.

The Landman and the Gas company have a full understanding of the value of the mineral rights under your property. Their objective is to commit you to a lease for the least cost and with the terms biased toward the company. The lease is a very complex business transaction and represents a legal contract between you and the gas company. DEC does not have authority to regulate private contracts.

You have one opportunity to form a contract which is compatible with your planned use of your property. The terms and conditions of your lease need to provide the protection for your property and the area environment. The lease is the only vehicle which can provide protection and define the relationship between the two parties. These rules of engagement need to be well defined before the gas company starts working on your property. Once the work begins it is too late and you may have up to forty years to regret your decision.

Our objective as a landowner group is to help educate you on gas leasing and define terms favorable to your lease. We are landowners like you and are providing our help at our own expense.

Our group will obtain legal council, draft a base lease, and evaluate any addendums. A bidder's package will be assembled and offered to viable gas companies for competitive bid. There will be a small cost for the legal services which will be payable when you get you signing bonus. Strength in numbers will result in the best possible price

with the most favorable terms for your needs. We need to pull together to obtain this goal.

Sign up sheets are available at our website [www.tiogagaslease.org](http://www.tiogagaslease.org) and are in paper form at any meeting. There is no cost to join the group and you are under no obligation to sign the gas lease the group develops. You are eligible to join even if you are currently under lease with an ending term in 2010. Please sign up soon and talk to your neighbors, family, and friends. This represents the largest opportunity for you and future generations. Please make sure it is done with the up most care.



Photo of the Millennium Pipeline crossing Germany Hill on August 24, 2008

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