

# A Guide to Understanding What Your Lease Means

Important Information You Should Know Before Signing

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Picture provided by: <http://blog.appienergy.com/2012/02/marcellus-shale-redefining-pennsylvania.html>

## OIL AND GAS “TIDBITS”

### Some oil/gas tidbits you may need as you review a potential oil/gas lease:

**General:** A “LEASE DOCUMENT” as presented to you by a land agent, is not a lease...it’s the driller’s “offer to negotiate” and not more! You can amend it or discuss it as you see fit; then it becomes your “OFFER” to the driller – no matter what a land-agent calls it! Once you receive the “signing bonus”, or the “signing bonus” and driller’s signature, you’ve got a binding contract!

Be wary of any land agent that offers you an agreement. Insist upon seeing their credentials and verify the company they work for. Research the company to determine if they are a drilling company, or if they are likely to sell your lease and another company will drill. This may not be inherently bad, but is certainly something to consider. Ask if they have a deal in place to resell your lease at higher price. Some companies arrange these deals prior to you signing your lease and do not have to tell you this unless you ask (so ask!). If this type of deal is in place you may be able to negotiate a higher rate or lease directly to the other driller at a higher rate! Be sure to thoroughly review your offer before agreeing to it, if anything doesn’t sound right, inquire exactly what it means. If you know anyone who has an oil/gas lease, or may just know more about them than you, don’t be afraid to ask them to review your lease for you and see if anything doesn’t seem right!

**Below are some of the important provisions of your offer – which will appear on the “lease document”:**

- **Leasing Clause (usually the first paragraph of your “Lease”):** This clause states—once you sign and receive the bonus, you are making a transfer of your mineral rights to the driller to access your minerals via the surface of your property or via other nearby property

(horizontally); unless your “Lease” says the driller has no surface rights, you may be giving them away. In some states, the driller may have access to your surface, depending on the law.

Review your lease document for a list of what you may be giving away – especially note:

- a) Pipeline rights [“with appurtenant facilities above ground”—these need negotiated separately]
- b) Installation of electric power – do you really want this?
- c) Compression and collection facilities – these can be large and a nuisance. They may be prohibited by local ordinances.
- d) Use of oil, gas, and water from your land, free of charge by the driller – how nice of them, but do you really wish to do it? If you choose to grant surface rights, you’ll need to negotiate a payment for each potential right you intend to give away!

**Note:** Coalbed methane gas, sometimes mentioned on page one (1) of your Lease, belongs to the owner of the coal – is that owner you? A general rule of thumb is: whoever owns the coal or real estate in which the oil or gas resides owns the gas or oil contained in that coal or land.

**Note:** Test water regularly—if not “public” water—when drilling occurs near you.

- **Description:** This paragraph merely describes the leased land in terms of parcel number, deed book and volume number, the acres it covers, the name of the municipality, and the state in which it is located.

• **Lease Term:** This paragraph says the lease will be valid for a certain number of years (the primary term) and that the primary term may be extended beyond five (5) years if:

- a.) Royalties are being paid
- b.) “Operations” are being conducted by driller
- c.) Minerals are being produced in “paying quantities” in a unit of which you are some part
- d.) Minerals are capable of producing oil and gas
- e.) Minerals are later discovered and there is capability of production on your property or on property in a unit of which you are a part (pooled unit).
- f.) For various other reasons

**CAUTION:** the word “*operations*” (as sometimes defined in the lease) is very broad – read it carefully – some of it needs stricken as it sets forth too many possibilities, which may extend the lease term under the banner of “operations”.

Sometimes the “Lease” will indicate that the initial term under a “Lease” may be continued (extended), even if a well is plugged or abandoned, as long as “delay rental” is paid to you; an ambiguous phrase sometimes appears under the **LEASE TERM** which runs something like:

“Extension of the primary term can occur if operations are delayed, postponed or interrupted as a result of any coal, stone or other mining related operation, and, such delay will automatically extend the primary or secondary term without additional compensation for as long as the interruption or delay occurs...”

**Read carefully!** You don't want this kind of ambiguous language. Insist upon this language being redrafted to show limitations of context meaning/interpretation. If there happens to be any "delays" in the "operations", sometimes the lease will suggest an automatic extension of the primary or secondary term without additional compensation or performance by driller for a period of time equal to any such delay – amend that language so you get paid for delays.

• **Extension of Term:** Language appearing under this heading needs particular attention; it can allow the driller an extension during the first five (5) year term; i.e., under certain conditions via various means, i.e.:

- a.) Paying you the same amount as you initially received as a signing bonus
- b.) Drilling a well on your land
- c.) Drilling a well on other land in the unit of which you are a part (pooled unit)
- d.) By combining your land with others capable of producing in paying quantities
- e.) By "operations" as defined in the lease (which "operations" are frequently vague, ambiguous, and sometimes misleading)

• **Payment:** Look for the paragraph that states your "signing bonus" – is it clearly stated?

• **Paid-Up Lease:** This generally will infer that there will be no "delay rental" or other payment obligations by the driller, except to make royalty payments while drilling/producing.

• **Royalty:** For oil & gas in most states, lowest royalty numbers are one-eighth (1/8<sup>th</sup>) or twelve and one-half percent (12.5%), **BUT YOU** can shoot for (bargain) whatever you wish – 19%, 20%, 21% - go for it! **DON'T ACCEPT THE FIRST OFFER;** especially if you own multiple acres! Consider bringing together several neighbors to create a stronger bargaining group. Can you round-up 500 – 2,000 acres and their owners?

- **Acreage:** More acreage will mean a higher royalty! However, watch out for the post-well-head charges that can significantly reduce your royalty check – read it, understand it, and research it as you see fit before you sign. Try to limit them in the bargaining process.
- **Right to Audit:** You have a right to audit the bookkeeping of driller, but it normally requires a lawsuit and can be very expensive; it’s cheaper to get the language correct in the “Lease.”
- **Ad Valorem Taxes:** Attempt to have tax increases of any kind resulting from drilling paid by driller; examples: “roll back” tax under any change of use (of land) taxed by a governmental body and any other taxes generated strictly as a result of drilling and/or change of use, i.e. severance tax, impact fees (taxes).
- **Shut-In:** This amounts to an effort by driller to allow them to keep the lease vibrant (on-going) during periods when energy prices in the market (wholesale & retail) are at a low ebb or the driller needs to take action to improve production. In some leases, the driller may be asking to be forgiven for not making royalty payments, but sometimes drillers may have a duty to pay delay rental.
- **Manner of Payment:** This paragraph tells you how a driller wishes to pay you. Read and reread it - understand it.
- **Changes in Land Ownership:** Sometimes drillers request notice of a change in ownership. If you are selling your home or real estate, sell the surface and keep the mineral estate.
- **Title:** Hopefully, you actually own the mineral estate, but if you do not, the driller can withhold payment. Perhaps you’ve had title work done by a bank or title company to assure

you own the minerals, i.e., gas, oil and any other minerals, and perhaps the mineral coal. If for some reason you do not, you'll likely see no money.

- **Liens:** The lessee/driller may pay liens against your real estate with a resultant deduction against royalties, or otherwise. Know if liens exist before any discussions with driller.
- **Limitations of Forfeiture:** This paragraph normally provides that if you want to claim that Lessee/driller is in default so as you may declare a breach by them, you normally must first give them written notice, by certified mail, "return receipt requested".

Generally it also means that if you get an offer while the lease is in effect, (from another jobber or driller) to lease your premises (top lease), which you may get toward the end of term number one, you must first give notice of all terms and conditions of the new offer to your current lesser so as to allow them to match the new offer; read the paragraph *carefully*. Go online and learn about it!

- **Unitization:** This paragraph gives the right to driller/lessee to join your property with others to form a "drilling unit" and for your property to be "pooled" with others to form that drilling unit, i.e., develop your minerals along with and/or in conjunction with that of others. It also says that you agree to share in total available royalties to the extent of acreage you have in the unit. (You take a percentage of royalties available in proportion to the percentage your property as the unit relates to the whole.) Generally, the driller/lessee will want the flexibility to change the size of the unit, i.e., can then limit you to but a tiny portion of the unit. Sometimes, the lease will give the right to the driller to exclude a portion or all of your property from a unit and from production benefits (royalties)...you definitely don't want left out!

- **Free Gas: *REQUEST IT!*** Get enough per year. Do the research because there are inherent safety issues when you wish to incorporate raw gas for your heating needs.
- **Facilities:** If driller asks for and you provide a right-of-way, you generally can't plant or interfere with the right-of-way, and there's a limit on how close you can plant vegetation to it or to a structure being properly used by driller or driller's assign. This only occurs if you give away surface rights. The driller always asks for more surface rights than you'll be willing to give. (Remember, too, that any right you surrender in the lease deserves compensation. Don't be too quick to give "stuff" away, i.e., pipeline rights, telephone/electric line rights, compressor station, or install rights as to any moveable or stationary fixture, unless you are compensated).
- **Warranty of Title:** You only want to warrant title "Specially", not "Generally"; leave it to the title company to determine "general warranty". *General warranty* means the landowner (you) will defend any defect or title issues as to the whole world. *Special warranty* means that you only warrant what you hold and for the period you've held it.

**SOME TERMS TO WATCH FOR:**

- **Lease Development:** Sometimes driller/lessee will provide they have no duty to develop minerals from your land. Always resist that provision; if they get the lease, you want development and royalties. (Development of minerals means – generally – locate and mine them.)
- **Regulation:** Lessee's duties are governed by applicable laws, rules, and regulations of your state.



- **Arbitration:** Any disputes can be resolved by arbitration, a court, or a panel of your peers.

You'll always want to allow for appeal rights.

- **Surrender:** If Lessee has the right to surrender any part or all of the leased property, then royalty payments to you will be reduced or eliminated.
- **Successor:** This is anyone who takes title following the last person named in the "chain of title".

#### **LAND PROTECTION:**

- **Location Approval:** You want to be sure to retain the right to approve or disapprove where a gas/oil facility is placed on your land.
- **No Drilling Within 200 Feet:** No driller should be nearer than 200-300 feet from a structure. Lessee needs pay to you for any damages to growing crops; plow depth for pipes is and should be 36".
- **Timber Clause:** You need an appraiser to get a value of timber – lessee to pay you the appraised value. You should have the driller/lessee pay for the appraiser; usually, the appraiser must be "certified" by your state.
- **Clean Up Premises:** Driller/lessee to keep premises clean – if a well is to be placed on your lands, insist clean up to be done by drillers in the Lease. Give them three (3) months to clean up if a well is placed on your property.
- **Reclamation:** Lessee to fix what they destroy or damage.
- **Damage Protection:** Lessee is to pay you for any surface damage they cause.

- **Insurance/Indemnification:** Insist upon driller/lessee showing you their insurance coverage annually. It needs to name you as additionally insured (on the binder) at no charge to you.
- **Fences and Gates:** Lessee to employ fences and gates to prevent damage and protect areas in which they operate.
- **Right of Way:** Do not give away any surface rights without compensation. Insist that your lease or agreement specify the lineal footage of the right of way, the diameter of the pipe(s) they intend to install, the number of pipes they can install, how often they intend to and are permitted to revisit the area, the width of the right of way, if/when they be permitted to park equipment in the area, and if they are responsible (insured) for repair or compensation for damage to real estate, foliage, or personal injury?

**WATER PROTECTION:**

- **Ponds and Water Quality:** No water is to be used from your water sources without your written consent. I recommend they use no water from your land, except to the extent you perhaps have “public” water and natural sources, but do not use the natural sources on you personally. Have your water professionally tested prior to any drilling and periodically thereafter. Don’t rely on driller’s water test results.

**LANDOWNER PROTECTION:**

- **Depth Clause:** All/any rights you give for general pipeline- consider carefully, i.e.: 36” deep for piping ROW; however, this is an important decision—do you really want a pipeline under your surface? “Pipelines” carry rights of driller/owner to return and place more pipe later and

remove or repair existing pipe or a right-of-way on which you may not create permanent fixtures.

- **Entire Contract:** Contract interpretation can only occur by reference to the written documents.
- **Confidentiality Clause:** You are not to disclose the content of your contract with others – even though everyone does.

### **ADDENDUM:**

Usually, this is a way to state the signing bonus or royalty, or to discuss special matters.

### **NON SURFACE LEASE:**

Means **NO** surface rights normally, but read carefully.