PENN ROAR

Pennsylvania's Royalty Owners Action Report

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Check Stub Bill Gets Gutted in Committee

Press Release from NARO-PA Legislative Committee, 5/16/2011

Senator Gene Yaw along with 9 co-sponsors, from both parties, have introduced SB 460, an act regulating the terms of oil and gas leases, royalty check stubs, and division orders.

In its original form, SB 460 contained language that would have required gas companies to include certain information on each royalty check stub, including: a lease identification number and well identification number; month and year of sale of gas produced; total production taxes deducted; payee's decimal interest; and other information.

Originally, SB 460 also would have invalidated language in division orders that changes the language of the oil and gas lease. The bill would also have expressly prohibited gas companies from withholding royalties until a royalty owner executes a division order, and would have imposed interest and punitive damages on gas companies that did withhold royalties.

The original bill would have a required royalty owner to send written notice to a gas company if the royalty owner believed the gas company had not paid royalties in a timely manner, or if royalties had not been fully paid. Gas companies would have had 30 days to investigate and cure the problem; failing that, the bill would have authorized a court to award interest, punitive damages, and even strike the oil and gas lease.

After introduction, SB 460 went to the Senate Environmental Resources and Energy Committee, chaired by Senator Mary Jo White. The Committee has removed much of the language favorable to royalty owners. The language regarding division orders, and the language regarding timely and proper royalty payments, have been stricken entirely.

What remains are some relatively inconsequential requirements for royalty check stubs.

SB 460 has been an excellent example of the importance of the Environmental Resources and Energy Committee to bills that would benefit royalty owners, and the importance of remaining vigilant about these bills. The members of the Committee are Mary Jo White (Chair), Ted Erickson (Vice Chair), Lisa Baker, Elder Vogel, Don White, Gene Yaw, John Yudichak, Andy Dinniman, Daylin Leach, and Tim Solobay. Royalty owners may contact the Committee by calling 717-787-9684 or by email at energy@pasen.gov.●

Serving the Citizens Who Own Our Country's Natural Resources
National Association of Royalty Owners
NARO

Inside This Issue

www.naro-us.org

Comments on Duke University Study Regarding Methane Contamination of Water Wells

From the personal blog of John Hanger, Posted May 9 & 11, 2011
Former Sect. of Department of Environmental Protection Under Gov. Rendell

Duke University released today a study of methane contamination of water wells, finding that gas drilling has contaminated some water wells with methane. The study also concludes that frack fluids have not contaminated water wells. See http://www.dukenews.duke.edu/

The Duke findings are consistent with DEP findings that gas had migrated from some drilling sites to water wells, but that no case of frack fluids returning from depth to contaminate water wells had happened in Pennsylvania.

The Duke University study looks at 68 water wells in 5 counties, with Bradford and Susquehanna counties in Pennsylvania a main area of inquiry. Samples of the water wells were taken in July and September 2010.

The study concludes that methane contamination of a water well is 17 times more likely if the water well is within 1 kilometer of gas drilling.

When I served as Secretary of the Department of Environmental Protection, DEP documented cases of gas migration from Marcellus wells around Dimock in Susquehanna County and in Bradford county.

Duke also finds that the gas migrating is not Marcellus gas, but shallower gas that is encountered during drilling. This too is consistent with DEP conclusions.

Bradford and Susquehanna counties have had many more gas migration problems than counties in Southwest Pennsylvania. Had Duke University done this study in Washington, Greene, and counties in the Southwest it would have reached different conclusions. The reasons for the geographic difference in the incidence or rate of gas migration include geological differences in the counties, quality of gas drilling in the respective areas, or some of both.

In the case of 19 water wells contaminated by methane from drilling around Dimock, 14 of the 19 had methane removed by December 2010. DEP required the drilling company to plug and repair gas wells that reduced the gas migration. A settlement in December 2010 between DEP and the drilling company required payments to families that averaged $200,000.

DEP also proposed new gas drilling rules in 2009 that became final in February 2011. The new rules raise standards for the design, construction, and operation of gas wells to reduce gas migration pollution.

Gas migration has been a problem in Pennsylvania for decades, well before the first Marcellus well was drilled in 2005. The new, strong rules and the attention to this problem make this the time to reduce it sharply.

Frack fluids have not returned from depth anywhere in Pennsylvania and polluted one, single water well. That is a fact.

Frack fluids have been spilled at the surface and have caused minor impacts that have been cleaned up and paid for by the companies responsible.

But gas migrating from poorly designed or constructed gas wells is a real problem. It is a problem that existed prior to the first Marcellus well. And it is a problem with some Marcellus wells. ●

Check out the NARO-PA Chapter website:

http://www.naro-us.org/Pennsylvania

NARO members can log in to the members only message board to get reliable information about natural gas drilling in Pennsylvania.

- Research archived PENNROAR newsletters.
- Post a story of interest
- Visit the NARO Store for gas & oil publications
- Browse other state chapters to find out what's happening in other plays

Fact-Checking on Natural Gas Taxes in PA

By: The Commonwealth Foundation

Pennsylvania Budget and Policy Center's new report alleging the natural gas industry doesn't pay taxes goes beyond misleading readers to using inaccurate information in order to jeer support for a severance tax.

The first page of the report says corporations are avoiding corporate tax rates by filing as an LLC because it "allows them to avoid the corporate net income tax altogether."

This is false. LLC's are "pass through" companies that transfer profits to the owner—if that is an individual/individuals, they pay the PIT. But if the LLC is owned by a corporation, as is the case for many of the drillers, the taxable income is paid at the 9.9% CNI rate. (NOTE: PBPC plans to correct this error in a future version of the report).

Then the report also misstates facts when it says "80% of the total numbers of permit holders are now operated by LLCs or LPs." But the majority of drilling companies in the state are not LLCs or LPs.

Obviously, the union-backed Center thought it would build support for a severance tax if people thought the majority of companies were LLCs avoiding taxes—though neither point is true.

When the report cites the Congressional Research Service (CRS) study on federal tax reductions for the oil and gas industry, it fails to note the 2005 energy bill ***increased*** federal taxes for oil and gas, while offering greater deductions for "alternative energy sources". The CRS calculated that the oil and gas industry received a net tax increase of $1.36 billion in federal taxes, not a reduction. Pennsylvania Department of Revenue spokesperson Elizabeth Brassell points out several additional errors of the report in the *Wilkes-Barre Times Leader*:

The report is "a narrow look at old tax data" and used "less than ideal research methodology." Brassell said the report was based on data the department provided a year ago, and the department has since identified better research methodologies.

Brassell said some of the information in the report is either "blatantly wrong or misrepresented." For example, the assertion that only $13 million was paid by the industry in personal income taxes must be based on "faulty information," she said, "because we can't get that figure anywhere." ...

"In looking at it, state taxes paid by the industry so far in 2011 are already nearly exceeding what the industry has paid in all of 2010 and we're totaling collections in the hundreds of millions annually rather than the tens of millions," Brassell said.

Further, the report glosses over how much the gas industry is contributing, including

- An estimated $100 million in state and local taxes directly from industry and $289 million from indirect activity in 2009. This includes business taxes, individual taxes on wages, and taxes on royalties and lease payments.
- $64 million in royalties to the state from drilling on state-owned lands this fiscal year.
- $1.7 billion in royalty and signing bonuses to private landowners in 2009.
- $11 million to the PA Department of Environment Protection in fees in 2009-10, which entirely pays for DEP costs of inspection.
- $200 million in local road repairs and improvement in 2010.

Finally, it ignores the economic growth in PA linked to natural gas drilling:

- Department of Revenue data analyzed by Penn State found Pennsylvania counties with 150 or more Marcellus wells experienced an **11.36% increase** in state sales tax collections between 2007 and 2010. Counties with no Marcellus wells drilled experienced a *6.55 percent decrease* in sales taxes during that same period.
- Mapping job growth shows a pretty clear pattern that it is being fueled by the gas boom. ●

Legislative Update:

As Proposed Legislation Builds up, NARO-PA Policy Positions Answer the Call

The opening of a new legislative session always spurs a flurry of new bills being introduced. However, all of the excitement surrounding the Marcellus these days, has prompted an avalanche of proposals. As of May 13th, there are over 145 proposed bills containing the keyword "gas." While not all of these pertain to the Marcellus drilling, a great majority of them do. Searching keyword "natural gas" yields 67 bills, but this total doesn't include all the bills affecting the Marcellus.

So as not to waste valuable time evaluating bills that will never see the light of day, we must take an educated guess on what bills to spend time on by looking at the path determining how legislation becomes law. If a bill is introduced in either chamber, it must first go through committee approval and is subject to change. If it makes it out of committee, it goes to the floor for a vote. If it passes, the bill goes over to the other chamber. If changes are made in the other chamber, it goes back to the origin for a vote on the changed bill. Once a final version passes both the House of Representatives and the Senate, it must be signed by the Governor to become law.

Currently, the House of Representatives, the Senate, and the Governorship is controlled by the Republican Party, who is seen as much friendlier to the gas drilling industry than the Democrats. Obviously, opposition party proposals will be largely bottlenecked in committee or defeated in a floor vote, unless seen as largely representing bi-partisan issues.

Here are some of the bills, which affect us, as Marcellus interest owners. These highlighted bills, we expect will move forward or have already passed, and we as NARO-PA endorse.

All proposals have been carefully evaluated to ensure the cost consequence of the bill does not needlessly detract from the competitiveness of Pennsylvania's natural gas and the bill effectively accomplishes a specific goal.

NARO-PA Stance on Protecting the Environment:

Drilling in Pennsylvania is governed by the Oil & Gas Act, which was passed in 1984 and traditionally dealt with shallower gas production. Unconventional shales, like the Marcellus requires drilling deeper, higher pressures, greater volumes of gas, more water, and potentially, greater risk.

We favor raising some of these standards, as they pertain to the unconventional plays, to protect the water resources around the drill sites. However, legislation that needlessly subordinates our rights as property owners to develop our mineral resources, will be opposed.

SB 601 Yaw (R-23) Amends Section 103 of the Oil & Gas Act: This legislation would increase the distance that a natural gas drilling company would be presumed liable for any contamination of a water supply within 2,500 feet of an unconventional gas well, within a year after completion or alteration of a well, up from the current statute of 1,000 feet and 6 months presumed liability. The legislation would also further increase the horizontal distance a Marcellus well can be from an existing building or water supply, increasing the current standard of 200 feet to 500 feet. This can be petitioned for change, by the driller, in situations that would deprive a royalty owner of their right to produce or share in the proceeds of that well.

Where I feel this legislation oversteps is in Section 205 (c), its requirements for DEP to evaluate sites based on their impacts on public land, national natural landmarks, and historic sites. This opens the door to those qualifications superseding our rights in the future. If those rights are removed, there should be some reimbursement for an individual property owner's loss to the collective.

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Legislative Update Continued from page 4

NARO-PA Stance on Pipelines & Public Safety:

Although Landowners can contractually require "Gathering System" companies to meet the safety regulations that are required of "Transmission Systems," Landowners do not possess the knowledge and technical capability to ensure contractual compliance. Consequently, for the public's protection, it is incumbent upon the Legislature to enact legislation that, as an absolute minimum, requires Gathering Systems to meet the same standards as are required for Transmission Systems and authorizes the PUC to ensure compliance.

Additionally, to protect our children, grandchildren and the environment from hazardous material and erosion liabilities, companies should be required to remove pipelines when they are abandoned.

Nationwide, 29 of the 31 natural gas producing states regulate pipelines. Alaska and Pennsylvania are the only two that do not.

SB 325 L. Baker (R-20) Pipeline Safety

The measure includes a statewide registry for Class 1 Marcellus Shale pipelines, requiring operators to report the location and aggregate miles of the pipeline to the PUC.

While the federal Office of Pipeline and Hazardous Materials Safety Administration (PHMSA) has jurisdiction over all pipeline facilities, it relies on agreements with each individual state to inspect and enforce federal pipeline safety regulations. Currently, the Pennsylvania Public Utility Commission (PUC) is only authorized to enforce regulations for pipeline operators with public utility status.

Baker's bill gives the PUC authority to conduct safety inspections and investigations, respond to complaints, assess fines or penalties, and address service quality issues for gas and hazardous liquid pipeline operators consistent with federal pipeline safety laws and regulations. Operators will be charged registration and renewal fees so taxpayers are not forced to cover the cost of providing increased inspections and enforcement.

This bill has passed in the Senate 49-1 in April.

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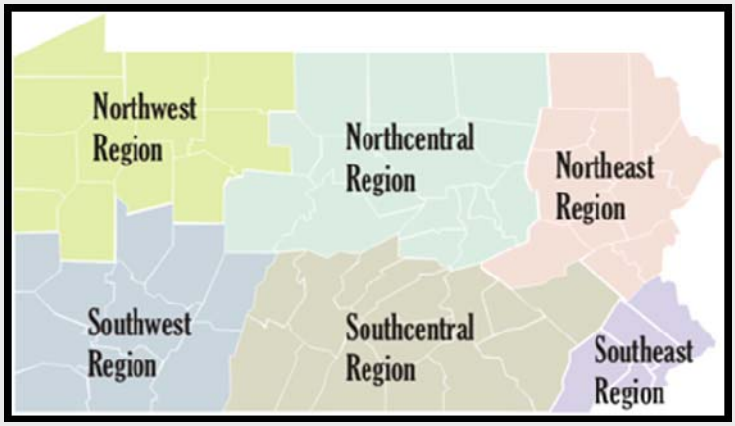

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Legislative Update Continued from page 5

HB 344 M. Baker (R-68) Pipeline Safety

This legislation is the House version of SB 325 except without the Class 1 pipeline registry. It has already unanimously passed the house this past April.

By adopting the Federal regulations without specifically addressing Gathering Lines, both the Senate and the House have, knowingly or unknowingly, limited the authority of the PUC with regard to a vast majority of the infrastructure that will be built to accommodate transportation of the Marcellus Gas.

NARO-PA Stance on Mineral Owners Relationship with the Industry:

Production of natural gas from private property is a partnership. The mineral owners own the gas, while the drillers have the means to produce and sell the gas. This makes production a partnership of the two. Mineral owners want to have a strong partnership with the industry, but we also want to be assured we are being treated fairly and our property is being adequately protected.

While we favor a strong, mineral owner-friendly lease as being the guiding document of operations, there are some aspects requiring intervention from the governing bodies overseeing the drilling.

SB 460 Yaw (R-23) Oil and Gas Lease Act: This legislation requires gas companies to list all deductions on royalty check pay stubs. Currently, the state of Pennsylvania does not require gas companies to list deductions from royalties paid to the landowner on monthly payments, and this proposal will provide openness and transparency for mineral rights owners, as seen in other natural gas producing states. This legislation would require companies producing natural gas to show on each check stub, attachment to a payment form, or other remittance advice:

- Lease identification number or reference to appropriate agreement with identification of the well or unit from which production is attributed;
- The month and year of sales or purchases included in the payment;
- The total amount of gas sold;
- Owner's final realizable price per MCF;
- The total amount of state severance and other production taxes paid, with the exception of windfall profit tax;
- Any other deductions or adjustments;
- The net value of total sales after deductions;
- The owner's interest in sales from the lease, property, or well expressed as a decimal;
- The owner's share of the total value of sales before any tax deductions; and
- The owner's share of the sales value, less deductions his share of the production and severance taxes, as applicable.
- The contact info like phone number and address.

This bill came out of committee with some key provisions stripped out of it, as detailed in the cover story. We need some pressure to be placed on House members, by our membership, to put those provisions back in. ●

The Policy Project is a work in progress;

Let us know what you think...

Appraising Natural Gas Royalty Interests in the Marcellus Shale

Part 1 of 3

By: Atty. John Shoemaker, Greevy & Associates

Over the past three years Richard J. Miller & Associates, Inc. has conducted appraisals of roughly 200 oil and gas royalty interests in the Marcellus Shale for properties located primarily in a five-county area of north-central Pennsylvania including Bradford, Lycoming, Sullivan, Susquehanna and Tioga counties. Appraisals done in 2008 were largely for non-profit clubs where the oil and gas rights had been leased but there was no drilling or production. However, as development activity in the region has increased and the circumstances on individual properties have changed it has become necessary to incorporate those changes into the appraisal of specific properties. Evolving appraisal procedures have had to consider more options for the property and have become more complex.

The properties for which appraisals are requested can be sorted into three broad categories:

1. **Producing** - In this case the property, or a pooled unit that includes the property, is producing and there are commercial sales of gas.

2. **Leased and Partially Developed** - There may be drilling permits submitted and approved, there may be a development plan in place, and there may be one or more wells drilled either on the property, or on a property with which it is pooled, but there is no production.

3. **Leased but Undeveloped** - The oil and gas rights are leased but there are no wells drilled or scheduled to be drilled, there may be no well pads and there may or may not be any well drilling permit requests submitted or approved for the property.

NARO-PA's 1st state convention was an overwhelming success.

We would like to thank Chapter President Jacqueline Root for her dedication in planning this event and all of our sponsors who made it possible.

We hope to see you all next year!

Initially the last category was the most common, but the Leased and Partially Developed category now occurs more frequently. Each of these categories requires a somewhat different approach to the appraisal of the royalty interest. The following discussion reviews appraisal practices for oil and gas interests, the progress of development of the Marcellus in the five-county region, and the approach that may be taken to appraise properties in each of the categories.

Standard Appraisal Practice

Generally accepted appraisal practice recognizes three approaches to value for most types of properties; the Cost Approach, the Comparable Sales Approach, and the Income Approach.

The Cost Approach, which estimates value based on the cost to replace or reproduce a structure or facility, has no application to oil and gas property appraisal since the property cannot be reproduced or replaced by new construction regardless of investment. A well that turns out to be a dry hole has no value regardless of the cost of the well. Each field and property is unique both in time and in terms of the development and operation of the property by the owner(s).

The Comparable Sales approach, which has wide usage in real estate appraisal, has very little use in the appraisal of oil and gas properties for several reasons. The primary reason is that, unlike residential and commercial real estate, there is no common database of transactions from which to draw information. The only information that may be available through publications or hearsay is that a certain property was sold and maybe the purchase price. The appraiser may have some information about production, number of wells, oil gravity, and other parameters but unlike a residential property where the appraiser can obtain square footage and other information, often from a multiple-listing service, there is no such source for oil and gas properties. Further, the number of reported sales of oil and gas properties, whether producing or undeveloped, in any period of time, is limited in comparison to the number of properties in production. The relatively small number of sales reduces the ability

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of the appraiser to determine a common parameter with which to measure the comparability of the sales that do occur. Very few of those sales that have occurred and for which information is accessible have been of royalty interests. Finally, the differences between the properties that have been sold and the property being appraised are often numerous and significant requiring that substantial adjustments to be made to the "comparable" sales relative to the subject property. The number and extent of these adjustments would be difficult to define, given the paucity of sales, and could alter the character of the comparable properties such that it would not be certain that the actual purchaser's concept of the value of the property would remain unchanged.

Oil and gas properties have most commonly been appraised, for virtually all purposes, by the Income Approach. This choice results (a) from the concerns regarding the other two methods that are expressed above and (b) from the acknowledgment that it is the method most commonly employed by investors in and appraisers of oil and gas producing properties. The use of the Income Approach requires that there be sufficient information on which to base a valid and reliable appraisal.

Development of the Marcellus Shale in Pennsylvania

The Marcellus Shale is a relatively recent target for leasing, exploration, and development. The potential for gas production from shale formations has been known for decades but the difficulty of extraction led companies to seek easier sources. The current activity by companies in the Marcellus shale is derived from the successful development of the Barnett Shale in Texas and of the Haynesville Shale in Louisiana/Arkansas using horizontal drilling and hydraulic fracturing. The apparently successful development of the Barnett and Haynesville has encouraged companies such as Range Resources and Chesapeake to attempt to apply the technology that allowed commercial production in those formations, with some variations, to similar geologic formations such as the Marcellus. The result was an upsurge in oil and gas leasing activity, particularly in the north-central part of Pennsylvania, starting in 2006 and continuing through 2010. The competition for leases led to the payment of extraordinary amounts for signing bonuses and for delay rentals

An oil and gas lease is a contract between the owner of the oil and gas rights (the Lessor) and a party interested in exploiting those rights (the Lessee). Marcellus gas lease terms commonly included an initial or "primary term" of five years; delay rental payments if a well is not drilled in the first or subsequent years; a royalty of 12.5%; and provisions that allowed the Lessee to automatically renew or extend the lease, pool or unitize the property with other leases, and use the property for gas storage. Unless the Lessor has been careful to edit and amend the standard lease terms the Lessee often has the right to automatically extend the lease for at least a few years and sometimes another period equal to the primary term. In addition, the Lessee can, again depending on the terms, convert the lease to "held by operations" by doing certain work, often defined broadly, on the property.

Leasing has been followed by geophysical survey work covering large areas; increases in applications for permits to construct pipelines and gathering systems; siting of well locations; filing of requests for drilling permits and; more recently, drilling and completion of wells and the start of production in those areas where pipeline connections are available. The pace of this activity is shown by a few statistics (Tables 1-3). In 2007 the Pennsylvania Department of Environmental Protection (hereafter "DEP") approved only seventeen drilling permits in the five-county region [2]. In subsequent years the number of approved permits has increased in each year to 364 permits in 2008; 1,010 permits in 2009; and 1,884 permits in 2010. Virtually all these permits were for Marcellus Shale wells. While these wells may not all be drilled the level of permitting suggests strong interest in eventual development. According to the DEP a total of 1,191 Marcellus wells were drilled during the 2007-2010 period with the number of wells increasing in each year. The DEP has also reported that 394 Marcellus wells were in production in the five counties as of December, 2010. The total production from these wells through December, 2010 was 266,934,805 MCF over a total of 95,003 days of production; an average of 2,810 MCF per day per well [3].

The available data does not allow an assessment of the initial production rates, decline rates or pressure response [4]. Until recently, operators

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in Pennsylvania did not have to report oil and/or gas production. In 2010, the state began to require that operators report gas production for each well. However, the production is reported only every six months and is cumulative to that date; there are no monthly production rates; and there is no pressure data or other information that would allow a performance history for the well to be defined. The data does serve to allow rough comparisons between wells and producing areas, i.e. one well produces 50 MMCF over six months as compared to another well that produces only 20 MMCF over the same period, but that is all. Absent a rigorous production reporting system in Pennsylvania, analysis of production depends upon data obtained voluntarily from operators and interest owners. •

Footnotes:

1) There are leases that were granted in the early part of the decade that had no bonus and paid annual rentals of $2 or $5 per acre, however, by 2008/2009 bonuses and rentals (often combined in a "paid-up lease) were commonly $1000 per acre and higher.

2) Bradford, Lycoming, Sullivan, Susquehanna and Tioga Counties.

3) Data from DEP website at https://www.paoilandgasreporting.state.pa.us/publicreports/Moules/Production/ProductionHome.aspx

4) Marcellus data provided is total gas production by well from July 1, 2009 through December, 2010 along with the number of producing days and well location. There is some data reported for production prior to July, 2009 which may or may not be Marcellus gas.

Look for Part 2 of 3 in the July 2011 issue of Penn ROAR where we discuss the three categories of appraisals in depth.

Gas Leasing 101

Negotiating a Pipeline Right-of-Way Agreement

By: Attorney Dale A. Tice, Marshall, Parker and Associates

In 2008 the gas leasing boom was at its peak. Landowners throughout the Marcellus region of Pennsylvania were approached with Oil and Gas Leases, and thanks to the efforts of the Penn State Cooperative Extension educators, many landowners had a good idea of the potential pitfalls in signing a lease and the importance of legal counsel.

Now, many of the same landowners who signed a lease are being requested to sign a Pipeline Right-of–Way Agreement. The need for pipelines is readily apparent – gas companies are drilling hundreds of wells, but in many cases are unable to transport gas production due to the lack of pipeline infrastructure, or because existing lines are already at maximum capacity.

Landowners should understand that the provisions of a pipeline agreement are negotiable, just as terms of the oil and gas lease they signed were open to modification. In fact, while it has become increasingly difficult to negotiate favorable gas lease terms as the competition for leases has decreased, the gas companies are often willing to work with property owners on pipeline agreement terms. It is absolutely critical for the drillers to develop the pipeline infrastructure, so landowners are in a good position to negotiate.

As always, a landowner's ability to negotiate a favorable contract will depend on a variety of factors, including the location and size of the parcel and the drilling activity in the area. The issues of concern in signing a pipeline agreement will vary among landowners, but there are a number of common issues that will be important for almost all property owners to consider before allowing pipeline construction on their land.

Payment – As the Marcellus play has matured, payments for pipelines have increased in a manner similar to the dramatic increases in cash bonus payments for leases. In most cases landowners will be paid based on the length of the right-of-way calculated in linear feet. Compensation of $15 per foot is not uncommon, and in some cases pipeline companies have paid substantially more. The landowner may also request an additional payment as compensation for surface damages. The Internal Revenue Service construes payment for the actual right-of-way as capital gains, while the payment for surface damages is taxed as ordinary income. It is advisable for landowners to consult an accountant in regard to questions about taxation of payments under a pipeline agreement.

Location – Landowners should always retain the right to control where on their property the pipeline will be placed. A detailed map showing the location of the proposed pipeline should be included as part of the agreement and there should be no deviation from the location as shown on the map without the landowner's consent.

Number of Pipelines – Most right-of-way agreements will give the gas company the right to place multiple pipelines on the property and will also allow the company to place additional pipelines on the right-of-way in the future with no additional compensation to the landowner. If the landowner is amenable to multiple pipelines, the company should be requested to provide payment for each pipeline; the cumulative payment may exceed $50 per foot. The agreement should state that the company may not place additional pipelines in the future without a separate written agreement, thus giving the landowner the opportunity to negotiate further compensation at that time.

Natural Gas Only – The agreement should allow transportation through the pipeline of natural gas and associated non-liquid hydrocarbons only.

Water Line – One of the major, very legitimate complaints about Marcellus development is increased truck traffic on local roads. A substantial portion of the traffic arises from transportation of water to well sites for hydraulic fracturing. In an effort to reduce truck traffic, many companies are now placing surface lines in the area of existing pipeline right-of-ways to move water from impoundments to well sites. Many pipeline agreements will specifically allow the pipeline company to place a surface water line on the property, or to include a buried water line along with the natural gas pipeline. If the landowner agrees to allow a surface water line, the agreement should specify the duration of time the line will be allowed and require removal of the line when the period of time is complete. The agreement should state that any water line can be used to transport clean water only, and prohibit transportation of waste water from hydraulic fracturing operations. As with additional gas pipelines, landowners may negotiate additional payment for placement of a surface or buried water line on the property.

Right-of-Way Construction – Pipeline agreements are typically generous to the company in the amount of land granted for the right-of-way. Landowners may negotiate a narrower right-of-way, reducing the total acreage granted for the easement. The agreement may also specify the

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Gas Leasing 101 continued from page 10

pipeline depth and require conservation of topsoil for restoration of the site after construction is complete. If a driveway or road crosses the right-of-way, the property owner may request placement of a temporary crossing that will maintain access to the property during pipeline construction. Access to the area of construction should be restricted to where the right-of-way enters and exits the property, and the landowner may request placement of gates at the property boundaries to prevent use of the right-of-way as a recreational area by neighbors riding ATVs.

Surface Facilities – Most right-of-way agreements will give the pipeline company the right to place various surface facilities on the property, including pipeline testing equipment such as pig launchers and catchers, and potentially even a compressor station. It may be hoped that the companies operating in the Marcellus would not attempt to place a compressor on the landowner's property under the terms of a pipeline agreement. However, the landowner should request written clarification stating that no surface facility or above-ground equipment of any type will be placed on the premises without the landowner's separate, written consent. If the landowner does not object to permanent surface construction, additional payment for the loss of use of the surface should be requested.

Landowner Indemnity – It is not difficult to imagine various scenarios where a person could be injured, or property damaged, as a result of pipeline construction operations. As the owner of the property where the injury occurred, the landowner could potentially be named as a party to a lawsuit if the injured party attempts to recover damages. Recognizing the potential for liability, landowners should always demand a strong indemnity clause in any pipeline agreement, requiring the pipeline company to defend any lawsuits and pay any claim for damages that arise as a result of its operations on the premises.

Timber and Crops – In many instances the proposed pipeline will cross areas with valuable timber or crop fields. However, the agreement presented to the landowner will typically be drafted so that the payment per foot is the total compensation, and will thus not require any additional payment for the diminution in value to the landowner when the trees and crops are cleared. Landowners who own property with timber or crops may request additional payment for trees harvested during pipeline construction and the loss of crops. The value of the timber in the area of the easement may be determined by appraisal prior to construction, and payment for crops should be based on the current fair-market value.

Restoration – Any pipeline agreement should require that the company restore the area of the right-of-way to pre-construction condition. The landowner may require that all large stumps and rocks be removed and that smaller brush is mulched. Many individuals request a specific seed mix for site restoration that will provide cover and grazing for wildlife. Farmers may request soil testing and subsequent fertilization to ensure that the area of the pipeline is restored to the same level of soil fertility as the neighboring fields. The pipeline company should be required to maintain the right-of-way in a clean condition after site restoration.

Termination of Easement – The pipeline agreement as drafted by the company will create a permanent easement for the right-of-way on the property. It would be preferable for the landowner to include verbiage terminating the easement when the pipeline is no longer being used to transport natural gas. With the potential for Marcellus wells to produce for over twenty years, and even greater potential if the Utica shale is developed, the easement granted in the pipeline agreement could continue for a very long time. Nevertheless, it is to the landowner's advantage for the easement to terminate at some point, even if the date of termination is in the indefinite future. The landowner may also request that the pipeline company remove the pipeline and restore the property to pre-construction conditions at such time as the easement terminates.

Perhaps the most critical point for the landowner to keep in mind is the importance of consulting qualified legal counsel when negotiating a pipeline right-of-way agreement. The information provided above is of a very general nature and is intended only to highlight common concerns. Each landowner will have unique issues that should be discussed with an attorney and addressed in the pipeline negotiations. ●

Meet the NARO-PA Founders

On the Road with Jacqueline Root, Chapter President

On May 11th I had the opportunity to address the Governor Corbett's Marcellus Shale Advisory Commission- Local Impacts and Emergency Response subcommittee. The thirty minute presentation was my perspective as a PA mineral owner, farm operator, landowner advocate and last but not lease NARO-PA Chapter President. I had suggested, during the public comment portion at a previous meeting, that the mineral owner was a key stakeholder in oil and gas development but was typically not represented in discussions that directly affect our interests. My invite to present to the subcommittee was a major step in getting our organization and cause into the forefront of the debate.

The negative press can be overwhelming and often the actual experiences are not conveyed. I attempted to share a real picture of the activity while recognizing areas that truly need attention. Marcellus Shale developed over the last three years, in our township, has shown dramatic improvements in several areas. Industry has implemented changes that 1) improve safety with larger well pads, 911 numbering and first responder training; 2) reduce environmental risks with lined pads, containment systems around holding tanks and production equipment; and 3) address road impacts by rebuilding affected roads and piping water to reduce traffic.

This was also an opportunity to leave the commission with some thoughts on what most concerns the mineral owner and how regulation can affect our ability to develop:

- Regulatory layers that unnecessarily delay drilling or pipeline is of great concern.
- It is important to remember that the subsurface is the dominant estate and though best management practices should always be used on the surface, the mineral owner's right to develop their resource cannot be limited.
- When any reportable incident occurs on a worksite, surface owner notification should be required.
- Water testing within 2500' or even 4000' of a gas well would satisfy more surface owners and better protect operators.
- Methane detectors should be installed in dwellings within the potential impact area of a pipeline where odorization is not required.
- Dust control continues to be an issue that should be addressed more aggressively.
- Taxation in the form of a severance tax or impact fee, if enacted, should be reasonable and the majority, if not all, distributed to areas impacted by the drilling.
- No tax could possibly make PA more competitive for future development.
- Consideration should be given to the overall tax burden on PA royalty owners including federal, state and the constant threat to take away the depletion allowance.
- Last but not least, the Oil and Gas Conservation Law was enacted to prevent waste and protect the correlative rights of mineral owners in the exploration and development of the resource. Currently well units are created based on #1 Leasehold and #2 Geology. A more equitable conservation law would promote efficient development and more lease options in a less competitive market.

The mineral owner is a key stakeholder in this game and must be considered when drafting new laws concerning development. DEP is best equipped to regulate O&G within the Commonwealth. Progress must be recognized and further encouraged. We must manage the impacts but also promote development that will maximize the resource and prevent waste. ●

DEP Fines Chesapeake Energy More Than $1 Million
Penalties Address Violations in Bradford, Washington Counties

DEP Press Release, May 17, 2011

HARRISBURG -- The Department of Environmental Protection today fined Chesapeake Energy $1,088,000 for violations related to natural gas drilling activities.

Under a Consent Order and Agreement, or COA, Chesapeake will pay DEP $900,000 for contaminating private water supplies in Bradford County, of which $200,000 must be dedicated to DEP's well-plugging fund. Under a second COA, Chesapeake will pay $188,000 for a Feb. 23 tank fire at its drilling site in Avella, Washington County.

"It is important to me and to this administration that natural gas drillers are stewards of the environment, take very seriously their responsibilities to comply with our regulations, and that their actions do not risk public health and safety or the environment," DEP Secretary Mike Krancer said. "The water well contamination fine is the largest single penalty DEP has ever assessed against an oil and gas operator, and the Avella tank fire penalty is the highest we could assess under the Oil and Gas Act. Our message to drillers and to the public is clear."

At various times throughout 2010, DEP investigated private water well complaints from residents of Bradford County's Tuscarora, Terry, Monroe, Towanda and Wilmot townships near Chesapeake's shale drilling operations.

DEP determined that because of improper well casing and cementing in shallow zones, natural gas from non-shale shallow gas formations had experienced localized migration into groundwater and contaminated 16 families' drinking water supplies.

As part of the Bradford County COA, Chesapeake agrees to take multiple measures to prevent future shallow formation gas migration, including creating a plan to be approved by DEP that outlines corrective actions for the wells in question; remediating the contaminated water supplies; installing necessary equipment; and reporting water supply complaints to DEP. The well plugging fund supports DEP's Oil and Gas program operations and can be used to mitigate historic and recent gas migration problems in cases where the source of the gas cannot be identified.

The Avella action was taken because on Feb. 23, while testing and collecting fluid from wells on a drill site in Avella, Washington County, three condensate separator tanks caught fire, injuring three subcontractors working on-site. DEP conducted an investigation and determined the cause was improper handling and management of condensate, a wet gas only found in certain geologic areas. Under the COA, Chesapeake must submit for approval to the department a Condensate Management Plan for each well site that may produce condensate.

"Natural gas drilling presents a valuable opportunity for Pennsylvania and the nation," Krancer said. "But, with this opportunity comes responsibilities that we in Pennsylvania expect and insist are met; we have an obligation to enforce our regulations and protect our environment." ●

For more information, visit www.depweb.state.pa.us.

Harrisburg Needs to Hear from Royalty Owners

On April 27, 2011, NARO-PA Chapter President Jaqueline Root and Chapter Vice-President Trevor Walczak traveled to Harrisburg for the second meeting of Governor Corbett's Marcellus Shale Advisory Commission, in an effort to spotlight royalty owner's position in the Marcellus debate. At the end of the nearly six hour program, people willing to address the commission were granted two minutes to voice their concerns.

Of the 70+ commenter's who spoke, an overwhelming majority favored shutting down all Marcellus activity.

Political pressure is building in the non-Marcellus counties of the state who seemingly have little regard for our rights or understanding of the drilling.

Join us to show our support for responsible drilling at upcoming commission meetings:

Friday, May 20, 2011
Friday, June 17, 2011
Friday July 15, 2011

Co-ordinate carpooling with regional board members

Find out more:
www.portal.state.pa.us/portal/server.pt/community/marcellus_shale_advisory_commission/20074

2011 PA NARO Convention: A Thirteen Year Old's Perspective

By Uriah Franklin Frederick

NARO PA CONVENTION REVIEW

After attending the first annual Pennsylvania Chapter of the National Association of Royalty Owners (NARO) Convention, I made many observations. My most important finding was that the discovery of Marcellus natural gas is great news. It was very interesting listening to all the speakers although I have to admit, some of the time I read my book instead. Also many of the questions people asked were very specific and allowed the speakers to explore deeper into their topics. I will also share what I learned from the talks and I will give my reasons of why Marcellus natural gas is very important.

First I learned that natural gas will help reduce dirty coal use and reduce fuel-oil use. This is very important because dirty coal is extremely bad for the environment and we need to stop burning it. Each well can keep producing gas for up to 25 years or more and there may be 40 years' worth of Marcellus wells to drill. This will help us well into the future giving us some time to find the most eco-friendly energy sources, whether it is making more efficient windmills or more powerful and cheaper solar panels.

I also learned that natural gas development will produce a lot of jobs and income. If gas prices are high enough, well operators will have more money to reinvest in more wells. Gas companies employ many people and will employ more and more. Landowners who are fortunate enough to be in good gas areas will earn royalties, a percentage of the gas sales. For many that will mean finally a return on their land after paying taxes for years and years. There is also a lot of legal work to be done. I enjoyed hearing attorney Lester Greevy's presentation on dealing with family complications and gas money, maybe law is more interesting than I thought. There are also people who are able to rent rooms and houses to gas workers - this is important because it helps regular people who don't have much land. Motel/hotel owners benefit because of all the traveling around. Many people who own local businesses benefit because the traffic of gas workers will boost their businesses.
I learned that landowners should be very careful when signing a lease, whether it is getting the best land protections, a high royalty percentage, or if possible making sure that there are no deductions of costs before royalty calculation- they can really add up and don't gas companies have enough money anyway? To protect yourself you could and should either become an expert in leasing or get help from a knowledgeable attorney. Both choices are good but I would do both. Also I would check if the companies are following the lease and review royalty stubs ***v e r y*** carefully.

I learned there are many gas related fields I might study in college: geology, petroleum engineering, law, environmental science and business. In attendance there was even a Penn State grad student, a geography major, who is studying the power of land groups in leasing deals. I like it when landowners win good deals.
At the end of the 2 day convention, which was held in State College, Nittany Lion Country, I didn't see Joe Paterno but almost as good I did get to shake the hands of Dr. Terry Engelder, Marcellus expert and Professor of Geo Sciences at Penn State and that of Mr. Jerry Simmons, the Executive Director of NARO.
I was the only kid there, this turned out to be one time I was happy my parents made me go to something – kids out there, COME NEXT YEAR! ●

*** Uriah Franklin Frederick is in 8th grade, lives in New York City and will be attending the Bronx High School of Science in the fall. Uriah spends summers at his grandparents who live in Marcellus counties of Lycoming and Wayne.*