

PENNSYLVANIA STATE UNIVERSITY  
PENNSYLVANIA STATE UNIVERSITY



The Dickinson  
School of Law

Agricultural Law Resource and Reference Center

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# NATURAL GAS LEASES

*Understanding Your Rights  
Protecting Your Interests*

A fountain pen with a dark, marbled barrel and silver-colored accents is positioned diagonally across the lower right portion of the slide. The pen is resting on a document that has a signature written in blue ink. The background of the slide is a blurred image of legal documents, with a large blue triangle on the left side.



# The Leasing Process

- Landowner has initial contact with energy company.
- Energy company presents landowner with STANDARD lease agreement.
- Landowner negotiates additional terms to be included as addendum to lease agreement.



## Negotiation of Gas Lease

- **Lease agreement will govern nearly all aspects of relationship between landowner and energy company.**
- **There are many factors that impact the negotiation of terms in lease agreement.**



# Factors That Affect Negotiation of Gas Lease:

- Amount of acreage
- Physical features of property
- Geologic features of property
- Other production / infrastructure in area
- Number of companies in area
- Natural gas market
- Negotiating skills of parties



# **Considerations** **in Hiring an Attorney**

- **Landowner should inquire about attorney's experience with gas leasing.**
- **Landowner must be comfortable working with attorney.**
- **Landowner must understand the basis of all fees charged by attorney.**
- **Landowner should receive a written fee agreement from attorney.**



# Terms of Lease Agreement

- Parties to lease agreement
- Property description
- Length of lease agreement
- Payment terms
- Rights granted by landowner to energy company & limitations on those rights



# Parties to Lease Agreement

- **Lessor - Owner of natural gas rights**
  - Owner of surface estate need not be party to lease agreement.
  - **Dunham's Rule:** Reservation of mineral estate may not include reservation of right to natural gas.
- **Lessee**
  - Lessee could be an independent landman, an energy company, a drilling company, or other.
  - Lessee will change if lease agreement is later assigned.



## Parties (continued)

- **Assignability of Lease Agreement**
  - Most lease agreements are freely assignable.
  - Landowners should require notice of all assignments.





## Property Description

- **Property will be described by one or more of the following:**
  - **County and township**
  - **Metes and bounds**
  - **Acreage**
  - **Tax assessment parcel number**
  - **Neighboring properties**



## Property Description (continued)

- **Title search**
  - Lessee generally will perform a title search before making any payments.
  - Lessor should avoid providing a general warranty of title.
- **Horizontal severance**
  - It is possible to limit exploration to a specific strata.



# Length of Lease Agreement

- **Primary term**
  - **Primary term is the number of years defined in lease agreement.**
  - **Lease agreement ends if production activities do not begin by expiration of primary term.**
  - **If production activities begin, lease agreement is converted to secondary term.**



## Length of Lease Agreement (cont.)

- **Extension of primary term**
  - **Force majeure**
    - **Act of God**
  - **Renewal at option of lessee**
    - **Terms of current lease agreement will continue.**
  - **Right of first refusal**
    - **Lessee has opportunity to match contract offers from other companies.**



## Length of Lease Agreement (cont.)

- **Secondary term**
  - **Secondary term begins upon the initiation of production activities.**
  - **Subject to the specific provisions in lease agreement, secondary term can extend far into the future.**



## Length of Lease Agreement (cont.)

- **Secondary term can extend:**
  - “so long as operations are conducted”
  - “so long as gas is produced”
  - “so long as gas is produced in paying quantities”
  - “so long as a well is capable of production”



# Payment Terms

- **Bonus Payment**
  - This is a one-time payment to landowner.
  - It is paid at execution of lease agreement or within a short time thereafter.
  - The amount is negotiable.



## Payment Terms (continued)

- **Delay Rental Payments**
  - These are payments to landowner at times specified in lease agreement.
  - The obligation to make scheduled payments terminates when a well is drilled.
  - The amount and number of payments is negotiable.





## Payment Terms (continued)

- **Royalty Payments**
  - These are paid to landowner when natural gas is removed from the land.
  - Pennsylvania law requires that landowner be paid royalties of at least 1/8.
  - Landowner can negotiate for a higher royalty rate.



## Payment Terms (continued)

- **Shut-In Royalty Payments**
  - These are payments made to landowner when a well is drilled, but gas is not yet marketed.
  - The amount and circumstances under which payments are made is negotiable.



## Payment Terms (continued)

- **Free Natural Gas**
  - Lease agreement may provide for landowner to receive a specified amount of extracted natural gas at no cost.
  - Landowner is generally responsible for transportation of gas from wellhead to residence.
  - Landowner can negotiate to receive a payment in lieu of free natural gas.



# Rights Granted By Landowner

- **Mineral Estate**
- **Surface Estate**



## Rights Granted (continued)

- **Mineral Estate**
  - Mineral estate is severable from surface estate.
  - Lease agreement will specify what products within mineral estate are subject to grant.
  - Lease agreement conveys fee simple determinable title.



## Rights Granted (continued)

- **Surface Estate**
  - Energy company will seek **UNLIMITED** use of surface estate.
  - Landowner may want to limit energy company's use of surface estate.
  - Consider difference between the terms:
    - convenient
    - necessary



## Rights Granted (continued)

- **Landowner may limit use of surface estate by:**
  - **Defining the permitted activities**
  - **Requiring that landowner approve well sites and access roads**
  - **Specifying the conditions under which the land will be reclaimed**
  - **Requiring the installation of fencing or gates**



## Rights Granted (continued)

- **Property Damages**
  - Landowner should address potential damage to:
    - soils, crops, trees, buildings, roads, water, etc.
  - Lease agreement should provide method of valuing damages.
  - Landowner should consider inclusion of arbitration clause.





## Rights Granted (continued)

- **Water**
  - Landowner should require that all water be obtained off-site.
  - Lease agreement should address disposal of water used in drilling process.



## Rights Granted (continued)

- **No Surface Rights Lease**
  - Landowner may negotiate lease agreement that does not permit use of surface estate.
  - Landowner will generally receive lower payment terms in exchange for a no surface rights lease.



## Rights Granted (continued)

- **Storage Rights**
  - Landowner should avoid granting storage rights in lease agreement.
  - The grant of storage rights can effectively extend the lease term.
  - The grant of storage rights should be separately negotiated for additional compensation.



## Rights Granted (continued)

- **Transportation of foreign gas /  
Installation of pipelines**
  - Landowner should avoid granting transportation rights in lease agreement.
  - The grant of transportation rights should be separately negotiated for additional compensation.



# Additional Considerations

- **Pooling / Unitization**
  - **Royalties are paid on a proportional basis within drilling unit.**
  - **Lease agreement may provide for a well siting fee.**
  - **Inclusion of a Pugh Clause can prevent one well from tying up entire acreage.**



## Additional Considerations (cont.)

- **Indemnification**
  - Landowner should require indemnity provision in lease agreement.
  - Indemnity provision should include all costs of litigation.
  - Indemnity provision should encompass environmental harms.



## Additional Considerations (cont.)

- **Clean and Green / CREP / Farmland Preservation Programs**
  - Participation in these programs may limit drilling activities or result in imposition of penalties.
  - Landowner should seek to shift all potential financial liabilities to lessee.



## Additional Considerations (cont.)

- **Access to records**
- **Increased real estate taxes**
- **Imposition of severance tax**
- **Drilling clause / Development clause**
- **Removal or forfeiture of equipment**





## For More Information

- **Penn State Cooperative Extension**
  - [www.naturalgas.psu.edu](http://www.naturalgas.psu.edu)
- **Pennsylvania's Gas Rush**
  - [www.wpsu.org](http://www.wpsu.org)
- **Agricultural Law Resource and Reference Center**
  - [www.dsl.psu.edu/centers/aglaw.cfm](http://www.dsl.psu.edu/centers/aglaw.cfm)
  - Natural Gas Exploration Resource Area will be posted soon.