

Marcellus shale could be a boon or bane for land owners

Sunday, February 28, 2010

By Elwin Green, Pittsburgh Post-Gazette



Michel Sauret/Post-Gazette

This location is the first Marcellus Shale well set up by CNX Gas in Rogersville, which taps roughly 8,000 feet down into the ground and 2,700 feet laterally to draw from a shale of natural gas.

When CNX Gas Corp. was spun out of Consol Energy Inc. in 2005, the infant company began life as a coalbed methane producer with tens of thousands of acres of land. Only later did it realize it held 161,000 acres that could produce natural gas from the sprawling geographical formation called the Marcellus Shale.

Not having to sign a lease or to pay third parties for the right to drill that acreage gave CNX Gas a nice start on its move into shale, but the company has moved aggressively to bulk up. CNX Gas now holds lease rights to the gas underlying 250,000 acres, and is aiming for 400,000, said spokeswoman Laural Ziemba.

But even hitting that mark would leave CNX Gas far from being the biggest swimmer in the Marcellus pool. That would be Oklahoma City-based Chesapeake Energy, with 1.6 million acres. Range Resources, of The Woodlands, Texas, has rights to 1.4 million acres. Other local companies in the Marcellus include Atlas Energy, with offices in Moon, which has rights to 519,000 acres, and Downtown-based EQT Corp., with 400,000-plus acres.

The Marcellus Shale measures more than 95,000 square miles, or 60.8 million acres. The competition for natural gas in the shale is a competition for land. And where there is competition in business, money flows.

The rush by gas producers to tie up that land has left some landowners confused by the process, while others worry that they may not be getting the full value for the rights to their land. Meanwhile, some elected officials see reasons to consider setting up new rules to protect landowners.

Residents of rural areas are not the only ones affected. If the land rush plays out as it has in other regions, at least one observer said natural gas wells could eventually pop up in Downtown Pittsburgh.

For landowners, signing leases granting a gas company rights to the gas under the land can profit them in two ways.

First, when they sign the lease, they receive an upfront payment of rent for the term of the lease (commonly five years, with options to extend), often referred to as a bonus payment. That payment is stated as dollars per acre, and can vary widely.

Second, there is a continuing flow of money based on how much gas a well produces, stated as royalty of a certain percentage of the value of the gas. Pennsylvania law requires that landowners receive royalties of at least 12.5 percent, or one-eighth, of a well's production.

Representatives of the companies interviewed for this piece said royalties these days average around 15 percent.

Figuring out what those numbers can mean to a landowner requires adding a few more numbers to the mix.

Range Resources spokesman Matt Pitzarella said a live well would typically produce about 4.4 billion cubic feet of natural gas during its lifetime, which can be 50 years or more. If the wholesale price of natural gas were to average \$5 per thousand cubic feet during the well's life, that production would be worth \$22 million, making the landowner's share \$3.3 million.

But the money will not come all at once, nor will it even come in a steady stream.

Gas production is a matter of diminishing returns: A well's output begins with a rush, then declines into a long tail so that about half of total production happens within the first two years. Thus, about half of a landowner's payments will come within the first two years. Using the above numbers, that would add up to \$1.65 million.

All of that assumes that a single landowner receives all the royalties from a particular well. In reality, a company must often negotiate leases with several landowners to assemble enough land for a "drilling unit" -- 640 acres, or one square mile.

How much the companies offer depends largely on how much they expect to get for the gas they find.

In the summer of 2008, Gene Partin joined with two of his Cecil neighbors, owning a total of approximately 100 acres, to bargain with Range Resources. In July, the wholesale price of natural gas approached the record set in 2005, post-Katrina. Range offered the trio \$4,000 per acre, with a 17.5 percent royalty.

"I thought a higher amount was realistic," Mr. Partin said, and he pushed for \$5,000 per acre with a 20 percent royalty. "But my neighbors were very eager to sign for that amount. My wife was, too."

So sign they did, in August. Which turned out to be not a moment too soon. Natural gas prices plunged that month, and in September the collapse of financial markets helped to send them even lower.

The crash of 2008 delayed the Partins' payment; they received their \$200,000 in January 2009. And there is still no well to generate royalty payments, nor have they heard from Range about any definite plans to drill one.

But Mr. Partin seems content; he and his wife used the bonus to help pay off their home, and are living mortgage-free.

While the Partins joined with only a couple of neighbors, some landowners have found it advantageous to form larger groups, both to share knowledge and to negotiate as a unit with gas companies.

One such unit known as The Friendsville Group brought together some 900 landowners holding a total of 35,000 acres in Susquehanna and Bradford counties in northeastern Pennsylvania and neighboring Broome County in New York.

In September, the group struck a deal with Fortuna Energy (now Talisman Energy USA Inc.), in which the company agreed to bonus payments of \$5,500 per acre and royalty payments of 20 percent. A day later, Chesapeake Energy countered with an offer of \$5,750 per acre and the same royalty.

But even the Friendsville Group lease pales in comparison to a deal recently announced between two companies, Houston-based Anadarko Petroleum and Mitsui E&P USA LLC, an affiliate of Tokyo's Mitsui & Co. Ltd.

Mitsui is paying \$1.4 billion for about 100,000 acres in a joint venture with Anadarko, primarily in north-central Pennsylvania. That works out to \$14,000 an acre.

In a conference call with analysts following Wednesday's release of Range Resources' fourth-quarter results, Range chairman and CEO John Pinkerton said that if Range were offered \$14,000 an acre, he would not sell.

Kris Vanderman, a Charleroi attorney who specializes in oil and gas leasing, does not expect companies to offer as much to southwestern Pennsylvania landowners as they have in the northeastern part of the state.

Mr. Vanderman said local deposits of Marcellus gas are thinner than those in northeastern Pennsylvania, so bonus payments here tended to be in the \$2,000 per acre range for the first five years.

That may be changing. While several individual landowners contacted by the Post-Gazette did not wish to publicize details of their negotiations with gas companies, e-mails received referred to offers of up to \$3,000 per acre. And postings on a website for landowners describe recent leases for as much as \$5,750 per acre, with 21 percent royalties.

The website, www.pagaslease.com, was created by Web developer Ron Stamets, of Lakewood, a small town in the northeastern corner of the state, as a cure for his own frustration when he was negotiating a gas lease in 2007, and could not find information online about how to do it.

"We had no idea that it would take off," he said. Now the site receives between 500,000 and 800,000 hits a month.

Mr. Vanderman said it was only a matter of time before wells appear inside the city of Pittsburgh, and that they could even appear Downtown.

"I would see no reason why that is not a possibility, if it is in the interest of those who own the gas rights to develop them as much as has been done in other areas."

Residents of communities such as Lawrenceville, Lincoln Place and Saxonburg already have reported receiving inquiries about leasing their gas rights.

Councilman Doug Shields, representing District 5 in the city, said that while landowners could benefit nicely from leasing their land to gas companies, more consumer protections were needed.

"Everybody's talking about what a boon the Marcellus Shale is, but there is nothing out there from the consumer side," he said. "It's caveat emptor."

For one thing, he said, signing a lease does not guarantee that a company will drill.

"They can segregate that portion of the land and never pump it, but keep it as an asset."

Mr. Shields said the commonwealth should protect consumers with legislation that requires advisories "on the face of the contract," similar to truth-in-lending provisions.

Gas company spokespeople themselves acknowledge the inherent imbalance created when, as Mr. Shields said, "A sophisticated buyer is dealing with a very unsophisticated seller."

"An educated property owner is the best property owner for us," said Dave Spigelmyer, spokesman for Chesapeake Energy and vice chairman of the Marcellus Shale Coalition, an industry group. "We encourage them to seek counsel before signing any legal instrument to convey their rights."

A gas company does its own homework before ever offering the lease, first by identifying parcels of land that hold production potential.

That potential involves more than determining the likely presence of gas. Other factors that may be involved include access to water for use in the hydraulic fracturing process, and access to the interstate network of pipelines that transport gas across the country (which sometimes requires building new connecting lines).

"When you're talking about \$3 million to \$4 million a well," Mr. Spigelmyer said, "you need to make sure that you can move that gas to market."

Once they're sure the site is worth leasing, the companies call in the landmen -- agents to represent them in reaching out to landowners and negotiating leases. These can be either employees or outside contractors.

Chesapeake relies heavily on contractor Dale Property Services, which set up an office in Cecil in March 2008, while Range and CNX Gas use a mix of employees and contractors.

With the multitude of companies in the Marcellus, there is no fixed order for doing things, but the remainder of the process will include at minimum a title search, the signing of the lease and the issuing of the bonus payment to the landowner.

Besides establishing a payment schedule and giving the gas company rights to the gas, the leases typically authorize companies to construct machinery such as wells and compressors, as well as pipelines and roads as needed to transport the gas and to move equipment.

They also include provisions for reclamation, or restoring an area after a well has been drilled.

Elwin Green: egreen@post-gazette.com or 412-263-1969.

"Money Q&A" and "Company Town" are featured exclusively at [PG+](#), a members-only web site of the Pittsburgh Post-Gazette. Our [introduction to PG+](#) gives you all the details.



First published on February 28, 2010 at 12:00 am