Introduction

Oil and gas are valuable commodities. Their presence beneath your land could mean extra income if you choose to grant a lease to an exploration company.

Exploration companies employ or contract with a professional called a “landman” to acquire leases of mineral rights to land with potential reserves of oil and gas. Not all landmen work for exploration companies. You may have already been approached by a landman who has asked you to sign a lease that allows a company to drill on your property. If you are approached, consider the offer; revenue paid to owners of leased land can be substantial. Risks and inconveniences, however, are also possible. Make sure the lease protects your interests.

What is a Lease?

A lease is a legal document or contract between a landowner (lessor) and a company or individual (lessee) granting exploration and development rights to subsurface oil and gas deposits.

Companies will usually present you with a preprinted or standard lease. Review it very carefully and consult an attorney or other professional who is experienced with oil and gas leases. Negotiate changes to meet your needs and protect your interests before signing. Get all agreements and conditions in writing.

Entering into a lease agreement does not necessarily mean a well will be drilled on your property. Also, remember that you are granting a right to others which may be viewed as an encumbrance on the property.

Key Components of a Lease

Cash Bonus - An up-front payment or bonus which is generally computed on a per acre basis for signing the lease. It is considered to be the first year’s rental.

Primary Term - The number of years that a lease is in effect. It can be from one to ten years or more.

- **Delay Rental -** Annual rental payments paid to the lessor after the first year of the primary term, usually on a per acre basis.

Secondary Term - The duration of a lease is extended beyond the primary term if a producing well is drilled on the lease or if the lease is “pooled” with other leases to form a “unit” for a producing well. The lease is “held by production”, extending its duration, and expires when production ceases.

- **Royalty -** Your share of the production from beneath your property. This will be referred to in the lease as a fraction - usually 1/8 of the value of the oil and/or gas produced and sold.

- **Shut-in Royalty -** Payment in lieu of a production royalty. Paid when a well is “shut-in” (capable of production, but not producing) for maintenance or other reasons.

Termination - Occurs when the primary term expires or when economic production ceases during the secondary term.

Before Signing, Think About...

Land disturbance from an access road and drill site. The actual drilling of a well is a temporary activity that may involve a large amount of equipment similar to other construction projects. Be sure that you know how much of your land and which parts of it will be used for access, drilling, production, pipelines, compressors and short or long term storage of equipment. Have mutually approved reclamation plans incorporated into your lease.

Damage to crops, buildings and other personal property. The lease can also be written to require fences or other safeguards if needed to protect people and/or livestock. If not covered in the lease, consider asking for terms that make the company responsible for damage to crops, livestock, buildings and other personal property.

Free gas. Leases may provide for natural gas for the landowner’s use if a well is drilled on the premises. If the lease does not specify that the company is responsible for the cost of equipment and installation, then you may have to pay for it. Because of safety concerns, the company may provide a monetary payment in lieu of free gas as an alternative.

Lease Assignment. The lease may contain a clause which allows the company to assign or sell the lease to other firms.

Underground gas storage. Gas production reservoirs are ideally suited for underground gas storage after the gas has been produced. The lease may contain a clause which permits gas storage in return for an annual rental payment. As with many other terms of a lease, this clause is negotiable.

NYS DEC’s Role

DEC does not regulate private agreements between landowners and operators. Staff do, however, lease large tracts of state land for oil and gas exploration and development.

DEC’s Division of Mineral Resources (DMN) regulates oil and gas activity in New York and is mandated by Article 23 of the Environmental Conservation Law to protect correlative rights, the environment and public safety. Rules and regulations require that well drilling, casing, stimulating, completing, producing and plugging techniques be designed to protect groundwater and to prevent pollution, waste of oil and gas, and migration and commingling of oil, gas, brine and fresh water.

DMN staff review well drilling and plugging permit applications and issue permits for all wells in New York, whether on private or public land. Staff conducts inspections before a well is drilled, during the life of the well, and after the well is plugged and abandoned. Staff may also be present at the well site during operations such as the cementing of well casings, drilling through the productive formation and final plugging of the well. Before a drilling permit can be issued, operators are required to post a bond or other financial security to guarantee that the well will be plugged and the site reclaimed. Staff also administer comprehensive well reporting, compliance and enforcement programs.

Drilling a Well

Drilling will typically last approximately two to four weeks, depending upon many factors, including the depth of the well and the time of year. Deep gas well drilling may last two months.

Once an oil and gas company determines where to locate a proposed well, the company must obtain appropriate permits from the DEC. Contractors will construct the access road and drilling pad to accommodate the drilling rig and other equipment. The drilling location can range in size from less than one acre to two or more acres depending on the depth of the well. Trees and vegetation will have to be cleared and dust, noise, and exhaust fumes will be generated by the drilling rig and heavy equipment during drilling operations. Drilling is a temporary disturbance, but some impacts, such as removal of vegetation, may be longer in duration.

If the well is capable of production, most of the drilling site will be reclaimed within 45 days, depending on weather. Wellhead assemblies, meters and various tanks will remain on-site, near the well location, for the life of the well.

If the well is not completed or is no longer capable of production, state regulations require that a plugging permit be obtained and that the well be plugged and the site reclaimed in accordance with the regulations. If you have specific plans for the site, you may want to negotiate a specific reclamation approval clause in the lease.

Pooling & Compulsory Integration

A productive well will capture oil and gas which has accumulated in an underground rock formation or reservoir. A well may capture oil or gas from more than one property. Therefore, an area called a spacing unit, usually made up of more than one property, is assigned to each well. If you own the oil and gas rights of your property in a spacing unit, you are entitled to the opportunity, or correlative right, to receive the benefits of drilling in the spacing unit. If you lease, the royalty paid under your lease is based on your share of the spacing unit.

The law was amended in 2005 to define statewide spacing unit sizes based the depth of the reservoir and/or the target rock formation. If a proposed unit conforms to statewide spacing, then no comment period or hearing is required before the Department issues a permit to drill. If the proposed unit does not conform to statewide spacing, the Department must seek public comments and may be required to hold a hearing.

If the well operator does not control all the oil and gas rights in the spacing unit, the Department must address compulsory integration through a separate hearing process after the permit is issued.

Remember

The lease is a legal document and should be reviewed by an attorney or other professional who is experienced with oil and gas leases. Leasing provides you with revenues, but you should also make sure your interests and property are protected.

Check out our other brochure, "Landowner's Guide to Compulsory Integration Options", for information on the compulsory integration process at: http://www.dec.ny.gov/energy/1590.html

DEC Contacts

Well drilling permits, production, leasing:
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Counties: DEC Region 8: Chemung, Genesee, Livingston, Monroe, Ontario, Orleans, Schuyler, Seneca, Steuben, Wayne, Yates; DEC Region 7: Broome, Cayuga, Chenango, Cortland, Madison, Onondaga, Oswego, Tioga, Tompkins; DEC Region 6: Herkimer, Jefferson, Lewis, Oneida, St. Lawrence.

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Counties: Chautauqua, Cattaraugus, Allegany, Wyoming, Erie, Niagara.

Well drilling permits for all other counties, well spacing and compulsory integration statewide:
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For more information, visit the Division of Mineral Resources website at:
http://www.dec.ny.gov/energy/205.html

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Division of Mineral Resources

A Landowner's Guide to Oil and Gas Leasing

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