

# QUESTIONS AND ANSWERS ABOUT THE HAYNESVILLE SHALE



From the Office of the Mayor, City of Shreveport



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## LEGAL DISCLAIMER

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## WHAT IS THE HAYNESVILLE SHALE?

The Haynesville Shale is a geologic formation of sedimentary rocks that may contain natural gas. Some people believe that it may be the largest onshore natural gas field in North America. Its discovery has led to a frenzy of activity, primarily by publicly-held oil and gas companies (such as Chesapeake, Petrohawk and others), their hired lease brokers, landmen and other persons hoping to “cash in” on the discovery. Most of this activity has involved people being offered the opportunity to sign mineral leases for their property.

At this stage in the process, oil and gas companies are scrambling to lease as much acreage as possible - which has created a “gold rush” atmosphere. Hundreds of landmen have been hired, just to work the north

Louisiana area. Competition among these companies and their landmen has resulted in many land owners receiving offers to lease their mineral rights, some for significant sums of money.

## WHAT ARE MINERAL RIGHTS? SURFACE RIGHTS?

Mineral rights are different from surface rights. Surface rights are the rights for the use of the surface of the land for residential, agricultural, recreational, commercial or other purposes. Mineral (subsurface) rights are the ownership of the mineral resources (oil, gas, coal, etc.) below the surface. Mineral ownership entitles the owner to explore for, develop and produce the mineral resources. **In Louisiana, Texas and many other states, mineral rights can be retained, transferred, leased or sold separately from the surface rights on a piece of property. This means that a land owner must also own the mineral rights to be able to lease them.**

## HOW DO I KNOW IF I OWN THE MINERAL RIGHTS ON MY PROPERTY?

**Owning land does not automatically mean you own the mineral rights.** A search of your deed or property title can tell you whether you own your mineral rights. If your current deed does not specifically discuss minerals, you may need to contact a professional in title research. **Most residential owners in this area own the mineral rights to their property.** In Louisiana, mineral rights can only be reserved (held by the seller of surface property) for ten years, either from the date of sale or from the date of the last production of minerals from the land.

## WHAT IS A MINERAL LEASE?

**A mineral lease is a contractual agreement between two parties - the owner of a mineral estate and someone else, usually an oil and gas exploration and production company.** The lease gives the oil and gas company or individual the right to explore for and develop the minerals that might be found underneath the leased property. In some cases, oil and gas companies, who want to remain anonymous for competitive reasons, will use independent brokers or landmen to acquire leases in an area without disclosing who will ultimately produce any wells drilled there.

A situation like the Haynesville Shale has historically attracted speculators and others who hope to profit from the leasing and exploration activity. In these cases, independent lease brokers and landmen (either with their own funds or backed by an investor) will acquire leases in hopes of selling them to a larger oil and gas company for a profit. Usually, these persons' offers to owners will be less than the actual market value of the leases.

**When a property owner signs a lease, they essentially become a partner with the oil and gas company. When the company holds a lease to your mineral property, you cannot lease those mineral rights to anyone else until the lease term with the first company expires. When the lease terminates, all rights to the minerals revert back to the mineral owner.**

## WHAT TO ASK A LANDMAN

- You may be contacted by a landman. A landman is the oil and gas company's contact person. A landman researches the deed records to determine mineral ownership, locates the owners and negotiates the leases with mineral owners.
- Landmen may work for one or many oil and gas companies. It is

important for you to ask the landman who he or she is representing and if the company that is leasing the land is also the company that will actually be drilling for gas near your property and operating the gas wells which are successful.

- You need to ask about the oil and gas company's experience, both in the Shreveport area and in drilling the kinds of wells needed to produce natural gas from the Haynesville Shale. The oil and gas company is asking to be your business partner. You should know as much about them as possible before you accept their offer. If you know other people who are mineral land owners, ask them what they know about the company who is contacting you.
- Ask for and contact references of other property owners who have dealt with or are currently dealing with the particular company.
- If you have concerns about tactics used by a landman, feel free to contact the oil and gas company for whom they work. You may also get information from the Ark-La-Tex Association of Landmen at [www.altapl.org](http://www.altapl.org).

## LEASE PROVISIONS TO CONSIDER:

**The lease provisions listed below are not a complete list or explanation of mineral lease terms and the description of them are not intended to replace the advice of an attorney or other professional. Mineral owners who are unsure of their rights or who do not fully understand the terms of their lease should seek advice from an attorney or other professional who is experienced in Louisiana oil and gas law before signing any documents.**

These are some, but not all, of the provisions contained in a typical oil and gas lease:

- The **legal description** of the area and number of acres involved.
- The **primary term of the lease.** The term may be for any period of time, but it is customarily between one and five years (three-year terms are ideal). Many leases allow for the renewal of the lease or allow it to remain in force without your permission (not a good thing). If the company develops a production unit which includes your land and produces gas from it, your lease will almost surely be continued in force automatically beyond the original term. This is known as “held by production” acreage. It is important for owners to understand exactly how these provisions affect their land.
- **Lease bonuses** are a guaranteed, up-front payment of money that is usually paid upon the signing of the lease or within a specified short period thereafter. It is usually calculated in dollars per acre, or sometimes in dollars per lot. **This amount will be paid to you even if no wells are drilled or if they do not produce oil or gas in commercially-viable quantities. The amount of bonus payment is a figure negotiated between the owner and the oil and gas company.** The amount of the lease bonus may or may not be in the executed lease, mostly for competitive reasons within the oil and gas industry. Often, a “lease memorandum” or other document will contain the actual amount.
- A **royalty clause.** The royalty is the share of the oil and gas production that is paid to the mineral rights owner. It is usually shown as a percentage or fraction of the proceeds received from the oil or gas that is produced from the leased property. Many citizens are

initially offered a 3/16 (18.75%) royalty in their first offers, but 1/4 (25%) royalties are being offered for many Haynesville Shale leases. **Royalties are NOT paid unless someone drills a well in a production unit which includes your land and the well produces oil or gas in quantities which are marketable.** It may be years after the lease is signed before drilling occurs. If a well or wells are successful, you may receive royalties for many years.

- Information about **how royalties will be paid.** The lease will describe when the first royalty payment will be made once production begins and how often thereafter payments will be made.
- A **“surface operations” clause** describing whether and how landowner approval may be given for the location of a well, tank, pipeline or access road is desirable, especially if the lease involves land where any of these might be located. If the owner wants to assure that the drilling company will not disturb his land in any form, a “no drilling” or “no surface rights” clause is needed.
- A **“surface damages” clause** describing the payment of damages for property and crops destroyed or harmed by drilling operations is appropriate, especially if the land being leased is currently being used by the owner for other purposes.
- **Leases are complicated legal documents. Ask to receive a copy of the lease to review at your own pace and to share with your family and legal advisors. NEVER let someone pressure you into signing a lease in haste!**
- **If it’s not in writing, it’s not in the lease!**

#### HOW MUCH WILL I GET PAID TO LEASE MY LAND?

It is easy to become excited at the thought of receiving substantial income from the lease of your land for mineral exploration. Anyone who has ever heard the “Beverly Hillbillies” theme song may believe that such things are possible.

It is normal to be concerned about whether the bonus numbers and royalty percentages you are being offered are comparable to what other owners are receiving. Looking foolish because you leased for a much smaller amount than your neighbors is not a feeling most of us want.

**The royalty and bonus amounts offered by an oil and gas company and ultimately accepted by a property owner are a negotiation between two parties who both have something the other wants.** Many factors go in to what an oil and gas company offers you. Some of them include the availability and cost of a well site in the vicinity, how close the area is to existing pipelines (to carry the gas to market) and what the company’s geological data tell them about the prospects and risks for successful drilling in your area. **Gas wells like those needed for the Haynesville Shale formation typically cost \$5-8 million each to drill. Companies will pay more for locations where they think they have the greatest chance for success.**

However, another factor which is important to consider is **competition.** There are several firms who have committed large sums of money in an effort to secure leases in the Haynesville Shale. Among these firms are some with considerable experience in recovering natural gas from shale formations or who have deep roots in the Louisiana oil and gas community. We have already seen this competition drive up the per-acre bonus payments offered to property owners from \$200 per acre a few

months ago to numbers in excess of \$10,000 per acre in some cases. It is impossible to predict where the market will lead in the Haynesville Shale area of Louisiana, particularly until we see whether the wells drilled in this area are successful and economically viable.

In the Fort Worth area, where the Barnett Shale has been in very successful production for more than ten years, lease bonus payments in excess of \$20,000 per acre are now common. Royalty offers, which were often less than 20% a few years ago, now commonly are 25% and even higher in those areas.

#### HOW CAN I GET THE BEST PRICE FOR MY LEASE?

**There is no way to determine whether the prices you are offered are absolutely the highest prices available to owners in your area.** However, you can protect yourselves from companies who wish to take advantage of the fact that most people have little or no experience in mineral leasing. You can:

- **Do your homework.** Talk to your friends and neighbors, your lawyer and other professionals who can give you good, unbiased advice and information on lease negotiations.
- **Organize.** If you and your neighbors are part of a neighborhood organization, negotiating as a group (ideally, by designating knowledgeable persons to do the legwork and make recommendations) is a good way to assure that you are treated fairly. If you don’t have a neighborhood organization, this might be a good reason to start one.
- **Try to use the competitive market to your advantage.** You do not have to receive offers from only one company. Do not feel beholden to sign with the first company who contacts you or to accept their first offer. Feel free to contact other firms to see if they are interested in leasing your property.
- **Understand the market.** In a competitive and uncertain situation, someone who waits to lease has a chance that they could get a higher price than what is being offered today - and, just as possible, takes the chance that the Haynesville Shale is not what the oil and gas companies predicted and that no one may be interested in leasing their land at all if they wait too long. **There are no guarantees! Don’t be greedy!**
- **Understand that there will be pressure to “lease now or be left out.”** It is true that Louisiana mineral law favors those who lease their property before a well is drilled. Persons who wait will not receive lease bonuses and may have royalties withheld until the well makes money for the oil and gas company. Taking your time and negotiating with the company is advisable, but there are risks in waiting too long.

#### NO ONE HAS CONTACTED ME... WHY?

Oil and gas companies will not lease every parcel of land in Northwest Louisiana, even if the Haynesville Shale proves to be wildly successful. In some areas, there are no acceptable sites for drilling or the costs to install pipelines are too high. In others, there are so many owners (many not living in this area or who have multiple heirs involved) that it is perceived as too difficult to get the leases signed by enough property owners. It is reasonable to expect that more properties will be leased if the Haynesville Shale wells are very successful and fewer will be leased if the wells are less successful. There will also be “sweet spots” that are highly productive

and other areas which are shown not to be as productive. These factors will determine whose property ultimately gets leased.

#### WHAT ELSE DO I NEED TO KNOW?

- **The money you receive from mineral leasing is taxable income to you.** Upfront bonus payments are taxable as ordinary income, which may mean (depending on your tax bracket) that as much as 35-40% of your bonus will go to taxes. Even though royalty payments, if you receive them, are taxed at a lower rate, there will still be a substantial amount of tax liability. If you spend all of your bonus or royalty income and have nothing left to pay your taxes, the IRS will not be sympathetic! **Save at least 1/3 of it to pay your taxes.**
- **Natural gas production is not forever!** Quite often, gas production is highest in the first few months of a well’s life. That means that your royalty checks may be larger at first and then be reduced or even disappear after that. Counting on future checks to be as large as the first one is not a good idea.
- **Unless you own and lease a great deal of property, leasing your land will not make you “rich”.** Your share of a well’s income is dependent on how many acres of a “production unit” (often a 640-acre tract of land) you have, how many wells (if any) are drilled on it, how much gas is produced and the price of natural gas at that time. Although mineral lease checks are nice to receive (in any amount), the lease bonus and royalty checks which will come to the owners of a City lot may not dramatically change their financial picture. Many owners share in the proceeds from a single well, in most cases. As a result, royalty checks from even good wells are often relatively small.
- **If you are aware of elderly property owners in your area who have been contacted, offer to put them in touch with persons who can help them.** Elderly persons, particularly those with no family in the area, are often taken advantage of by fast-talking lease brokers.

#### WHAT CAN I EXPECT IF A GAS WELL IS DRILLED NEAR ME?

**Drilling a gas well is an industrial-type activity.** For many years, most wells were drilled in more rural areas, so there is understandable concern about the impacts associated with drilling in populated areas.

**By State law in Louisiana, the City’s regular zoning powers do not apply to gas well sites. Enforcement of all rules governing site selection, drilling and maintenance activities is the responsibility of the Louisiana Department of Natural Resources, Office of Conservation.** They have a Shreveport office at 1525 Fairfield Avenue and may be reached by phone at 676-7585 or on the Web at [www.dnr.louisiana.gov](http://www.dnr.louisiana.gov).

When a well site is selected, a pad site is prepared to hold the drilling rig and related equipment. Then, the well is drilled, completed and connected to a pipeline to take the gas to market. This process, which can take 30-60 days, is sometimes noisy and results in increased truck traffic. Responsible oil and gas companies select sites and access routes which have the least possible impact on the surrounding area. Once the well is in operation, noise and traffic generally return to their previous levels. Accidents can happen, as occurred in 2007 at a well site near Frierson. However, the industry’s safety record is generally good and residents should not unduly fear drilling activities.