

Gas Leasing Terms to Know

Part 2 of a Series

If you are leasing – or plan to be leasing – rights to gas in the Fayetteville Shale in north central Arkansas, you should learn as much as possible about the leasing process and terminology. This article is the second in a series dealing with issues related to oil and gas leasing.

Keep in mind the lease agreement is a binding agreement, or contract, between two parties. It will be the basis of a relationship that may last 30 years or longer if drilling operations begin during the term of the lease. The importance of a well-written lease cannot be overemphasized.

This information has been adapted from “Hints on Negotiating and Oil and Gas Lease” by Judon Fambrough of the Texas Real Estate Center, as well as from the “Royalty and Surface Owner Information Brochure” available from the Arkansas Oil and Gas Commission.

Lengths of Leasing Agreements

The **primary term** of the lease is the amount of time a lease agreement will be in effect unless drilling operations begin. This term is usually 5 years on many of the leases in the local area, but can range from 3 to 10 years.

If drilling begins within the primary term, most leases will be automatically extended as long as the well is deemed to be capable of producing gas. This period of time is sometimes referred to as the **secondary term**.

Money from Leasing Agreements

One of the most talked about provisions in a lease is the **cash bonus** or **bonus consideration**. Although this provision is popular with landowners, it is certainly *not* the most important provision in the lease. The cash bonus is usually a one-time payment offered as an incentive to sign the lease. It may be fun to talk about how much you were offered, but when considering such a long-term agreement, this payment may not be very important in the overall scheme.

A landowner’s share of production or income from the oil or gas produced from the leased property is called **royalty**. Arkansas law requires this to be at least one-eighth of the money from selling the oil or gas produced. However, royalty can be calculated before *or* after expenses, and the royalty amount may also be based on other factors.

<p><u>Please note:</u> The royalty is a major factor in the lease, because it will determine the amount of money the landowner will receive over the life of the well.</p>
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Most leases will also include a **shut-in royalty**. This is a payment made to the landowner when a well is capable of production, but is shut down for some period of time. This is often \$1 per acre of the leased property. During a shut-in period of time, there is no gas production and no royalty from the sale of gas.

Common Lease Clauses

- A **pooling clause** is a part of most leases in this area. This clause allows the lessee (or gas company) to “pool” or combine leased property with other property. Usually this is done based on governmental sections. The wells are designed to drain the gas in the area as one unit.

When land is pooled, the owner is entitled to royalty on a proportionate share of the entire pool. However, the lessee will continue to hold the lease as long as gas is produced anywhere in the pooled area.

- A very important part of the lease is the **damages clause**. Most leases will clearly state that the operator or lessee is liable for surface damages. Often the damages clause in lease forms is not favorable to the landowner.

Make sure your interests are fully protected by having a damage clause written into your lease. Common concerns include disruption of operations (farming or livestock), roads, fences, restoration, etc. A timetable outlining when restoration of property is to be completed should be included as well.

- Another common feature of most lease forms is a paragraph called **warranty of title**. These usually state that the lessor (landowner) “warrants and agrees to defend the title to the lands herein described.” This means the landowner agrees to defend the title to the mineral rights should a dispute arise concerning ownership. Even if the claim is unfounded, the landowner must still defend against the claim for both the lessor and lessee. It may be in your best interest to negotiate to have this clause removed before signing your lease.

Remember, knowing what to include in a lease requires some serious thought. The advice of an attorney familiar with oil and gas law in Arkansas would be valuable and could help you avoid problems down the road.

More specific issues will be addressed in future articles. If you have questions, contact your county office of the University of Arkansas Cooperative Extension Service. The Extension Service is part of the University of Arkansas Division of Agriculture.

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