

Should You Join a Landowner Group?

Many Pennsylvania landowners are joining landowner groups and coalitions driven by news reports of very high lease rates and a strong desire to maximize profits. Many landowners also fear the complex lease process and find some comfort in being with a group. While the benefits of joining a group are often compelling, many landowners are unaware of the pitfalls and the long term costs that they may incur by their actions. However, with a little knowledge about groups, and help from their attorney, many landowners can make an informed decision about the best way to market their leasehold.

grow Gas Royalties



We can define three types of loosely defined landowner groups for the sake of discussion. Your group may vary!

- **Landowner Information Sharing Group** - is a group that bands together to simply share information about what companies are leasing in their area, what the current rates may be and the potential for special terms and sample addendums. No attempt is made to market the group acreage. Group leaders are all volunteers. Landowners can individually benefit from their leaseholds market value. Timely information to the group may allow energy companies to loosely gather larger blocks of land, but each lease still needs to be negotiated separately. This organization has the weakest bargaining power.
- **Landowner Coalition** - is a group that works together to become informed, maximize contiguous acres, and market their combined leasehold. They may have a voluntary or paid leader or consultant to make the bid proposals to the energy companies. Payment to consultant is only made IF the landowners lease to the selected company. While landowners are strongly encouraged to sign with the group, there is no binding legal document to compel them to do so. Landowners can benefit from their leaseholds market value, or choose to sign with the coalition if the terms are more favorable. The

drawback is that the energy company may offer less to a coalition since the members are not legally bound and many may not sign. This leaves the job of filling in the holes to the landmen.

- **Landowner Bargaining Unit** - is where all parties have signed pre-agreements or pledged that they will accept the lease terms agreed upon by the majority. This guarantees to the energy company that the “negotiations” are binding to the entire group and eliminates individual negotiations. This group has the strongest negotiating position with energy companies since it eliminates thousands of hours of negotiations and lease preparations with perhaps hundreds of landowners. Since all landowners will sign for the exact same rental fees and royalties, landowners in the bargaining unit will receive the average market value of group. Leaseholds with superior market value may receive less, but marginal acres will receive more than that what they would individually on the open market. Hence these groups may tend to attract more leaseholds with marginal market positions. Generally there is a fee associated with this group. It could be an up-front fee per acre or a percentage of the royalty, or both.

What are other considerations?

Many landowners feel that joining a group will give them greater bargaining power with the landman because of the larger block of land being negotiated. It is true that by grouping together, landowners offer companies more acreage, faster, and with less expense in making contacts and negotiating separate leases. However, landowners need to take into consideration that:

- Energy companies are looking for contiguous blocks of land to form drilling units. Land that is not contiguous, or blocks that are full of holes (acreage not in group) reduce the value of the group leasehold. Groups with poor organization or density may be poor choices.
- Landowner groups can become too large and magnify perceived shortcomings which can reduce the leasehold value to you

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- Make sure the group has a well defined leadership structure and written policies concerning: who decides what the final terms or lease proposal will be accepted; how will that group or individual make that decision; do you have any chance at giving input to that decision. These are important considerations if you are going to be bound by their decision

Landowners may also feel they lack the basic knowledge to effectively negotiate a lease and find comfort in negotiating within a group. This was especially true a year ago when information about lease rates and terms was very sparse. Today there are several good informational web-sites to help become informed and newspaper coverage has been keeping most landowners informed of the trends in rates and terms. However landowners need to understand that several factors may make signing a group lease a less desirable option. One is financial strength. A financially secure landowner may walk away from a lease of tens of thousands of dollars, whereas a retiree living on social security may vote to sign at a much lower rate. An absentee landowner may sign a lease without protection for the land, but a third generation owner may find the lack of environmental protection in the lease a deal breaker. The list goes on and on. But the main caution is that if you join a group:

- Be sure that other landowners in the group have similar goals and values as you and that you can have some input into the decision making process. That can be very difficult, especially in larger groups.
- Understand that the more a group deviates from the “standard” lease, the more they move out of a companies comfort zone, the greater the risk of rejection or diminished lease rates. Larger groups trying to be everything to everybody can sprawl into undesirable locations, or “over-addendum” the value of their acreage and leave their members with a poor lease or without any lease at all.
- Make sure you can “take or leave” the group or coalition lease without cost or obligation.

Working with a consultant

Many landowners feel that hiring a “consultant” to lead the group through the decision-making process is a win-win situation. However, before you do it’s important that you check their references . Get a few names to call, go on-line and search the internet for articles or ask the energy companies about the consultant. Be sure you understand what the consultant will do for you. Will they simply negotiate the lease and get you to a signing by the highest bidder? Or will they be there when the trucks show up to start drilling and represent you in any “discrepancy” between what you thought you signed and

what you actually signed?

How much is it going to cost you for the consultant’s services? Always know exactly what your cost will be. A “fee per acre” is easily calculated. A percentage in royalty is not. A one percent royalty fee may not sound like much but understand that it may easily be a **half a million dollars on one well over a twenty year period!** If there could be several production units on the group leasehold, multiply by the number of possible units. Now figure that each production unit could have over twenty(20) wells on it, so multiply that number by 20. The final figure could be millions per year!

Enter into a contract with the consultant that specifies the terms and the payment for services. Make sure that the consultant cannot charge other parties for the same thing you are paying them for. For example, the consultant may not collect a percentage or fee from the energy companies in addition to what you are paying him/her, without your consent. All costs of the deal must be visible to all parties and all bidding must be open and fully transparent to the group. Be sure the consultant is a viable business entity in the Commonwealth of Pa.

Finally, understand that the Marcellus play is just getting started. As the play matures, lease rates will continue to go up in some areas, and down in others. Those leasing five years from now may well find lease rates in excess of \$8,000 per acre or more in some locations. No landowner group or consultant has a crystal ball that can tell where those areas may be with certainty. However understanding the workings of different groups can help you choose how you market your leasehold wisely. Remember, keeping your leasehold at the shortest primary term possible will allow you to maximize your total returns and minimize your risk.

Good Luck!.....Ken Balliet
Natural gas Resource Development

Where can you get more information?

Penn State Extension maintains an informational website at <http://naturalgaslease.pbwiki.com> or call your local extension office.

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