



The Marcellus Shale:

Natural Gas Leasing



Provided by Jacobowitz & Gubits, LLP

Winter 2009/2010

HUNTING FOR...ROYALTIES?

By: Gary M. Schuster, Esq. and Penny Thelman



Hunting clubs stand to make significant income from gas leasing. While attracted to the likely economic benefits, clubs also have concerns regarding safety, noise and impact on hunting.

The most obvious safety concern is mixing flammable gas and guns. Could a stray bullet cause an explosion? What about intentional vandalism? Despite dramatic explosions often seen in films and TV shows, a bullet shot into a gas tank will cause a leak but virtually never causes ignition. The myth of the exploding gas tank was "busted" by the television show "Mythbusters". You can view this investigative episode at:

<http://dsc.discovery.com/videos/mythbusters-clips-exploding-propane-tank.html>.

Another concern is the health and safety of gas drilling personnel during hunting season. One possible solution is negotiating a lease that restricts drilling to dates outside of big game season. The risk is also reduced by existing New York State law prohibiting hunting within 500 feet of buildings and human activity. Experienced hunters know the properties they hunt on and position themselves accordingly.

Hunters are also concerned that noise and activity will disturb or drive away game. The drilling process is noisy and can be non-stop during the active drilling period of approximately 30 days. However, after the drilling is completed, the drilling rig is removed and the gas well pump installed. The only noise from a completed and operating the gas well pump is the hum from the compressor. Apart from the drilling rig, noise and disturbance comes from construction of the gravel access road to the pad site and the laying of the pipeline.

Anecdotal evidence suggests that large game become used to the well sites and actually appreciate the well site openings which provide better foraging than mature forest. Deer and turkeys grazing next to busy highways, and even bears strolling through neighborhoods, are no longer uncommon. The long range impact on game in the New York Marcellus Shale area will not be known until time passes and hunting tallies are produced. Some studies and information from regions outside the area can provide some insight into potential impacts. The western part of New York and Pennsylvania have had operating well sites for decades. The West Virginia Department of Natural Resources and West Virginia Department of Energy have information on "Managing Gas & Oil Well Sites for Wildlife" on their website:

<http://www.wvsoro.org/resources/WildlifeWellSiteMaintenance.pdf>.

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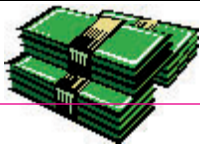
Access roads open up access to hunting areas. Usually there is only one road which leads to a small number of well sites within a large area. With the current technology of horizontal drilling, one well pad site can serve over 640 acres (1 square mile). Not every parcel within a drilling "unit" will have a well site. The actual above-ground disturbance of a completed well pad site, depending on how many wells are drilled, will be less than 1 acre.

Some hunters view access roads as a benefit and others do not. Some hunters believe that roadside vegetation provides better food source for deer and turkey than deeply forested areas. Others believe the road allows non-members to trespass more easily onto private hunting club lands.

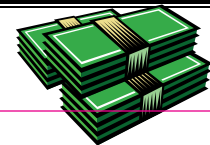
A well-negotiated lease could allow the club to influence where access roads will run on their property, and provide solutions to many of the other issues posed by gas drilling.

\$\$ Tax Rules for Hunting Clubs \$\$
 Many hunting clubs are formed as tax-exempt 501(c)(7) organizations. Special tax rules apply to these entities which put limits on the sources and amounts of their revenue. Excessive earnings over a number of years would jeopardize that tax exempt status. Royalties from a productive gas well would very likely be substantial enough to be considered excessive. Clubs also need to consider whether, and how, to pass those royalties into the hands of the members. Hunting clubs considering gas leasing must carefully plan for their future.

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THEY'RE BAAACK!



The Return of the Landmen

By: Jackie Henry-Thompson

In our 2009 First Quarter Newsletter, we featured an article entitled "Where Have All the Landmen Gone?" (article may be viewed at our website www.jacobowitz.com). In the article, we cited why the "landmen" would return. (A landman is an individual who negotiates gas leases with prospective mineral owners on behalf of gas exploration companies). There are several encouraging indicators which lead us to believe that it is likely gas leasing activities may resume as early as the 2nd quarter of 2010. The New York State Department of Environmental Conservation (NYSDEC) has issued its Draft Supplemental Environmental Impact Statement (SGEIS), a copy of which may be viewed at www.dec.ny.gov. The Final SGEIS is anticipated to be issued in the first half of 2010.

Large companies, particularly Chesapeake Energy, are convinced that there are trillions of cubic feet of natural gas trapped in the Marcellus Shale - and they are going to get it. Be prepared for the landmen when they start making their rounds. The landmen will be back and gas drilling, gas leasing and royalties will soon return as conversation topics around the dinner table, highways and byways.

As referenced in a New York Times editorial of October 17, 2009, "New York State's environmental regulators have proposed rules to govern drilling in the Marcellus Shale... The shale contains enormous deposits of natural gas that could add to the region's energy supplies and lift New York's upstate economy. If done carefully - and in carefully selected places - drilling should cause minimal environmental harm."

It is inevitable that natural gas exploration and development will happen in the Marcellus Shale area in New York. In order to take best advantage and be prepared for it, education is the key. Are you armed with sufficient knowledge to negotiate your lease terms when the landmen return?

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NEW YORK CITY OPPOSES DRILLING IN WATER SUPPLY WATERSHEDS

By: Gerald A. Lennon, Esq.

The NYC Department of Environmental Protection has called for a total ban on drilling for natural gas in its water supply watersheds, portions of which lie within Sullivan and Delaware counties. NYC gets its entire water supply from surface reservoirs, the waters of which are so pure they are not required to be filtered before use by the general public. If the quality of those waters is compromised by drilling for natural gas and related activities, NYC would be required, by USEPA regulations, to filter its entire water supply. The filtration plant alone would cost \$10 billion. The NYSDEC maintains that a drilling ban would



not be legal since about 70% of the land in NYC's watersheds are privately owned. Such an outright ban would likely be determined to be a taking, or condemnation, of the private property owners' mineral rights, subjecting NYS to huge monetary claims. A potential compromise position might involve significantly higher levels of regulations on any drilling within the NYC watershed areas. Given the large amounts of land in the Marcellus Shale area outside of the watersheds, such higher levels of regulations would likely delay any drilling in the watershed areas for some years, but would not delay the DEC's completion of the DEIS process so that drilling could resume outside of the watersheds. Chesapeake Energy Corp., which has significant lease holdings in portions of Sullivan and Delaware Counties, announced at the October 28th Sullivan County public hearing, that it will not seek to drill within the NYC watershed areas. That announcement, however, is not binding as to future activity.

The USEPA also submitted comments on the Draft SGEIS expressing a variety of concerns with the adequacy of the environmental review, chief of which seemed to be a concern for NYC's watershed protection. While the EPA comments did not call for a ban on drilling in the watersheds it expressed "...serious reservations about whether gas drilling in the New York City watershed is consistent with the vision of long-term maintenance of a high-quality unfiltered water supply."

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INDUSTRY CORNER

Independent Oil & Gas Association (IOGA) of New York held its 29th annual meeting in Niagara Falls on November 4-5, 2009. Attendance was reported to be the largest ever - understandable given the high level of interest in natural gas development in the Marcellus Shale area. One of the many industry presenters was Bill Zagorski, Vice-President - Geology, Range Resources Corporation (NYSE:RRC). Range was one of the pioneers in the Marcellus Shale play in Pennsylvania. Bill was introduced as the "Father of Marcellus Shale" given that he was reputedly the first industry engineer to recognize its natural gas production potential. Bill ended his presentation stating that he believed that the Marcellus shale play (in PA, NY & WV) is "one of the top ten oil and gas fields in the world."



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NYSDEC Closes Comment Period

The comment period on the Draft Supplemental Generic Environmental Impact Statement (DSGEIS) on the gas well permitting program in New York was officially closed as of December 31, 2009. The comment period had been extended from November 30, 2009. As part of the DSGEIS process, DEC held a series of public hearings in various areas in New York. The October 28, 2009 public hearing at Sullivan County Community College attracted a standing room only crowd of over 300 people. There clearly was a divergence of opinion in the crowd, with those opposed to any drilling program in the Marcellus Shale gas play area being the most vocal. A number of the speakers, including some local public officials, expressed guarded support for the program as a potential economic boost to the Catskills provided there were sufficient regulations to protect the environment. Two major areas of concern were the likely impacts on local roads and potential adverse impacts to both surface and groundwater resources. The potential impacts to water resources arise from the various chemicals that are in the "fracking" fluids used to open subsurface rock deposits to enable the recovery of commercially viable quantities of natural gas.



BREAKING NEWS