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THE GEOSCIENTIST AND THE LAWYER: RESOLVING THE CONFLICT BETWEEN WHAT YOU WANT TO DO AND HOW TO GET IT DONE

Lipman Biltekoff & Joy, LLP
333 International Drive Suite B-4
Williamsville, New York 14221
(716) 772-5544

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TOPICS

- Can You Do Oil & Gas Business in NY?
i.e., Process Predictability
- The Oil and Gas Lease
 - Process
- Landowner Coalitions & Industry Negotiations
- Compulsory Integration
- Unconventional Shale Gas Spacing
- Pipelines and Infrastructure
 - what, when, where, why & how – Just a Primer

CONCLUSIONS

1. Q: Can Industry Do
Business in NY?

A: Yes!

2a. Negotiable documents
creating lasting
relationships

2. The Lease

3. Coalitions

- 3a. Not Adversarial

- 3b. Certain Steps Can
Improve Attractiveness
to Prospective Lessee

CONCLUSIONS CON'T

1. Compulsory Integration
 - 1a. Not Coercive
 - 1b. Creates Options
 - 1c. Promotes Competition
 - 1d. KNOW YOUR RIGHTS

2. Unconventional Spacing 2. Hallmark of Flexibility

CONCLUSION CON'T

1. Pipelines

a. Gathering lines

b. Transmission

a. Essential to Market Gas

b. Require space

c. Generally do not generate revenue

d. Line-sharing

Agreements, Third-Party Gas

e. PSL 66g(3) v. Trunk Line Exception

• Interstate Lines

Not Covered Today

Can You Do Business in NY?

1. 100 + year history
2. 70K wells – 14K in production
3. ~ 56 Bcf/recent years
4. Oil Gas & Solution Mining Law (ECL Article 23) Revised 8/2/05 (L. 2005, ch. 386)
 - a. Modernized Process
 - b. Added Standardized State-Wide Spacing Unit Concepts
 - c. Automatic Conforming Unit Permits
 - d. Predictable Processes for Non-conforming Units, Variances
5. Non-Conforming Unit Process established by Statute
6. Statewide Spacing for Unconventional Shale Units revised in 2008
7. Statewide Jurisdiction under DEC DMN – Not Home Rule
 - a. Roads are local matters
 - b. Water is separately regulated
 - c. Disposal subject to SPDES
8. Process Streamlined but Subject to Change under SGEIS

The Lease

- Fully Negotiable Conveyance of a Real Property Right – the Right to Explore, Drill & Produce
- Runs with the Land – Important Legal Document
- Key Terms/Clauses are:
Granting Clause, Term (Primary & Secondary), Royalty (including actual production, shut-in, capable of production, lack of market, etc), Unitization, Reps & Warranties, Statutory Compliance with GOL; RP Acknowledgment for Recording

The Lease

1. Multiple Additional Terms – Fact Specific Negotiations, including:
 - Damages, Water Testing/Care/Replacement, Computation of Royalties, Storage Rights, Pugh Clauses (vertical and horizontal)
2. Right to Consult with Counsel – Absolute
 - Personal Opinion – I Would Seek Counsel
3. CASH SIGNING BONUS –NOT A LEASE TERM, COVENANT or CONDITION – NEGOTIAIBLE
4. Personal Opinion – The 2008 Lease Market was Grossly Overheated Bubble – Lease prices have fallen, economics did not support price and will not recur in foreseeable future

COALITIONS & INDUSTRY

- Myth 1 – Industry Does not Like Dealing with Coalitions
- Fact – Aggregate of acreage in single transaction desirable

- Myth 2 – Better deals in a Coalition
- Fact – Market/Geology Determines Price - Coalition or Not

- Myth 3 – Strength in #'s so Bigger is Better/More Powerful
- Fact – Acreage quality and location create value – size does not matter... EXCEPT bigger = few bidders

KEY ITEMS FOR COALITION TO ADD VALUE

1. Consolidate Acreage
2. Geology/Geophysical – Exclude Unproductive Areas
3. Committed Acreage – Ability to Deliver Leases in 1 Transaction
4. KISS Principals to Lease – More Terms Does Not = Better Terms
 - 4a. Company Must be Able to Operate on Leases
5. Lease “Book” with Coalition Acreage ID, Owner Names/Address, Regional Map, Run Title if Feasible, Include Offset Acreage if Feasible, Confidential??? Option Period to Negotiate
6. Coalition is Substitute for Land Service Companies
7. Best Coalitions Operate like best Land Service Companies

COMPULSORY INTEGRATION

1. Not a Coercive Process; Protects Mineral Rights

2. 4 - NOT - 3 Statutory Choices

(1) Integrated Participating Owner; (2) Integrated Non-Participating Owner; (3) Royalty Owner; (4) Voluntary Integration Agreement

3. Very Efficient – “Check the Box” Regulation

COMPULSORY INTEGRATION

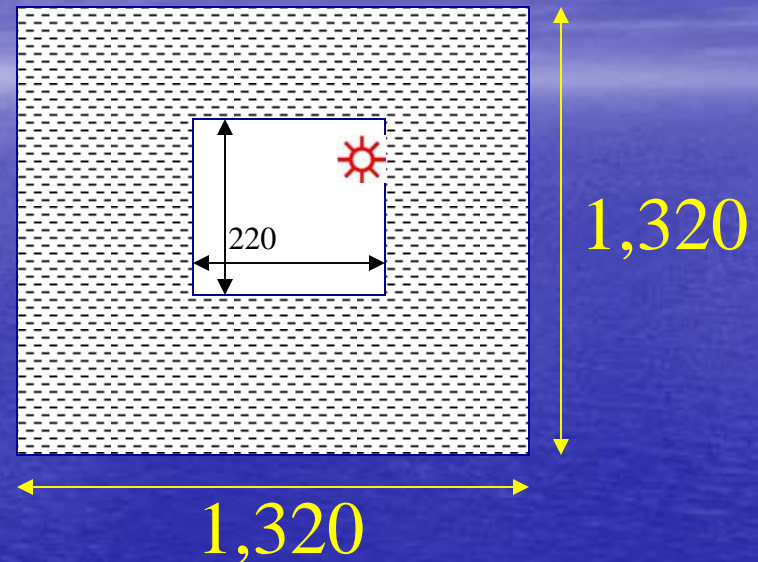
1. IPO – Pays AFE Costs before Drilling – Has Full Working Interest Rights
 - 1a. IPO is Oil and Gas Operator
 - 1b. Shares in all benefits and burdens of industry
 - 1c. Personal Opinion: Bad Choice for the Average Owner

2. NPO – Pays AFE Costs + 200% “Penalty” from Production
 - 2a. INPO is Oil and Gas Operator
 - 2b. Shares in all benefits and burdens of industry
 - 2c. Personal Opinion: It is the Best **Alternative** to Lease
 - 2d. Personal Opinion: Lease is better option for landowner

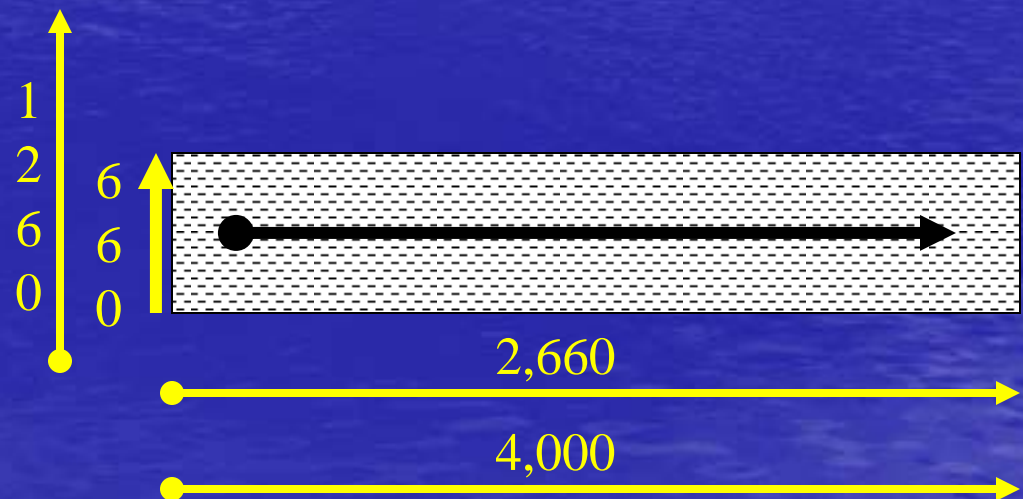
3. RO – No Risk or Liability - Receives 1/8th Gross Royalty
 - 3a. Personal Opinion: Worst Option of all – only for the “unidentifiable owner”

UNCONVENTIONAL SHALE GAS SPACING

1. Vertical shale pools
 - a. 40 acres unit
 - b. Wellbore no less than 460' from boundary
 - c. "Box in a Box" Unit

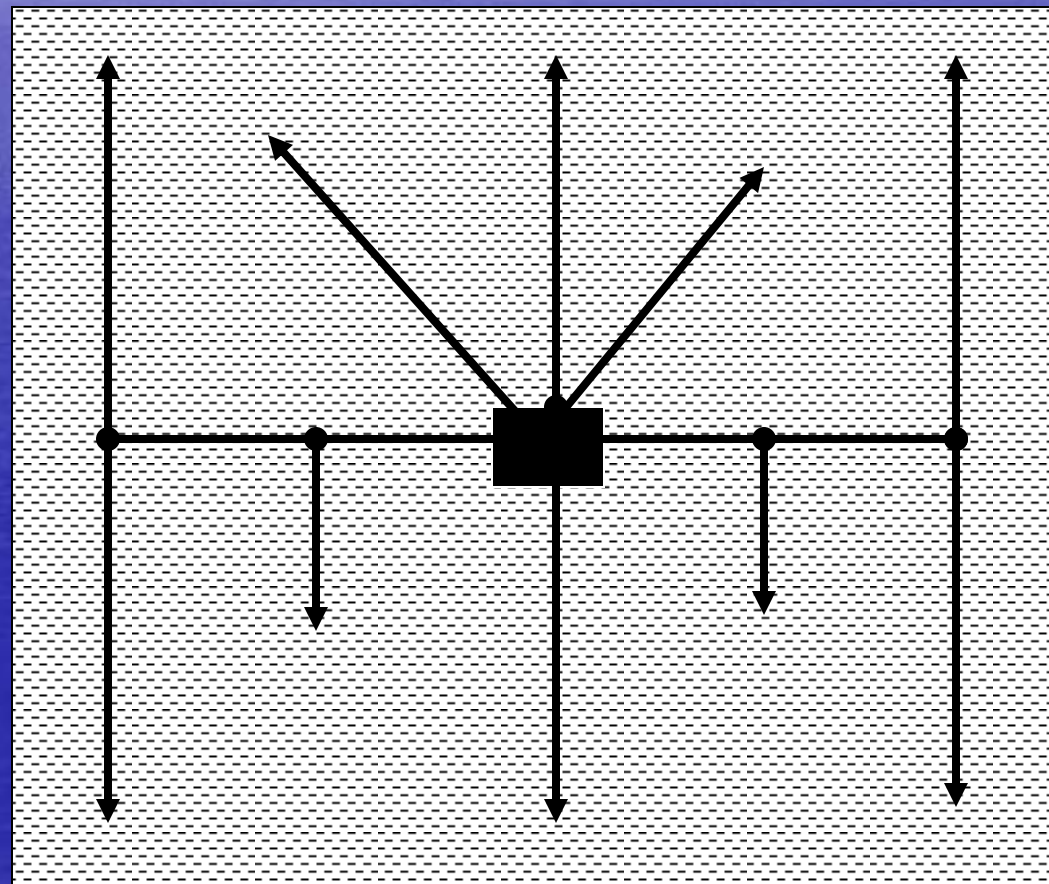


2. Horizontal shale pools
 - a. At least 40 acres
 - b. 330 setback
 - c. "Growth" Unit



UNCONVENTIONAL SHALE GAS SPACING

1. Horizontal shale from Common Pad
 - a. Drilling Commitment
 - b. Three years
 - c. Units up to 640 acres
 - d. Initial well centered
 - e. 330' setback



PIPELINES – I.E., INFRASTRUCTURE

1. Gas in ground is most valuable as a “proved reserve”
2. Well-site to Market-site (i.e., point of sale) = distance
3. Leases that disallow flow of gas inhibit production
 - 3a. Operator that cannot move A property gas across B property cannot operate
4. PSL 66(g)(3) exemption from all but safety regulation for gathering lines
5. Infrastructural demands & impediments may be most significant obstacle to full Marcellus and other shale potential

PIPELINES – I.E., INFRASTRUCTURE

1. Infrastructural Suggestions

- a. Modify PSL 66(g)(3) & Exclude “trunk lines”
- b. Encourage company cooperation via line sharing
- c. Discourage leases prohibiting gas transmission across properties or multi-line ROWs
- d. Size trunk lines and gathering systems to support full development
- e. Create the environment of cooperation

1. After Competition for Leases Ends

A Well Conceived and Constructed Infrastructure
Starts New York on the Road to Energy and
Greenhouse Gas Emission Freedom