

Corporate Communiqué

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Who or What is “Marcellus?”

By Samuel L. Douglass, Esq.

- a. The son of Augustus’ sister Octavia (or the 13 BC Theater named for him)?
- b. A Sainted Pope?
- c. A rich source of natural gas
- d. The middle of name Cassius Clay who later called himself Mohammed Ali?

Of course, all are Marcellus, but today, we are focusing on (c) natural gas - and be aware that gas producers are knocking on doors asking to lease the Marcellus shale located over a mile below the surface of the land - particularly in the hot spots where this shale is expected to be the thickest. The deposit runs from southern New York, includes most of Pennsylvania [other than the Philadelphia corner], part of Lake Erie, and extends into eastern Ohio, northern West Virginia, Maryland and part of Virginia. Shale thickness ranges from less than 50 feet to 250 feet. The gas potential is said to be enough to affect the current energy crises – *possibly enough to lower natural gas prices.*

The formation has been known for years, but only recently has the means of extracting the gas from the shale been developed. Rather than the historic 1/8th royalty, a royalty of up to 18.5% is sometimes possible. Anecdotal information indicates annual production royalties of \$500,000 per well, per year paid to land owners - sometimes more. For illustrative purposes, suppose a well produces one million cubic feet [1000 mcf] a day: 1,000 x \$10 [possible price per thousand cubic feet (mcf)] = \$10,000 a day x 365 days = \$3,650,000 x royalty of 15% = \$547,000.

“Landmen” [some are women] are descending on land owners and bidding against each other for a piece of the action on behalf of rich Texas and Oklahoma companies, as well as local producers. Producers are offering bonuses to get the attention of landowners – and it is working. A bonus for signing the lease is standard, perhaps \$300 per acre, per year. The lease bonus for gas can exceed the current value of the land.

As tempting as all this sounds, there are some things to think about before rushing to signing up, should you be approached:

- ⚙ **A royalty of 1/8? 15%? 18%? 18.5%? 3/16? OF WHAT?** Scholarly articles have been written on what’s what – without good answers. The price at the wellhead? This is a common term, but

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only useful if one can imagine a fellow standing by the wellhead with a bucket gathering up gas and handing out checks. Recently, producers seem more willing to look at the price paid at the transmission line, without a lot of deductions.

- ⚙ **Why is the print so small in most gas leases?** Every word is important to the Lessee. If you would put all those words in larger type, folks might be put off by the length of the document. Small print has the added benefit that maybe landowners will not want to try to read it.
- ⚙ **Can you find the “Do not believe a word I say!” clause in the lease?** Hint: It is usually near the end of the lease, close to the signature lines.
- ⚙ **What will they put on my land?** Maybe nothing, but more likely, at least one well and at least a temporary pond and roads and gas pipelines and electric lines and gas processing equipment and pump and structures and whatever else the Lessee might desire to make things work. Limits and controls on surface activities need to be considered.
- ⚙ **Why should I grant the right to store gas under my property?** You probably should not, at least not at the time of granting the oil and gas lease.
- ⚙ **What is the primary term?** The “primary” term is the period when the Lessee can do nothing and still hold the lease. Companies cannot immediately lease and drill all the vast acreage available, even if they should want to do so. They are likely to want reserves to keep operations going into the future. Purchasers of land burdened by a lease may worry about what the lessee-producer will do next and when he will do it. A short primary term is usually best for the landowner.
- ⚙ **What about lease extensions?** Although the “primary term” may be a lease for a 2 year, 3 year, or longer term, the lease may (and usually does) contain language that gives the Lessee many ways to extend that term.
- ⚙ **Must I warrant that I own the oil and gas?** No.

- ⚙ **If Lessee’s interest is in the Marcellus, must all the other oil and gas producing strata that I own be included in the lease?** Probably not.
- ⚙ **Why is coalbed gas included in the lease?** Good question. Some coal owner probably owns it.
- ⚙ **When will the drilling start that is going to make me rich?** Probably at the end of the primary term – even though you are told there is a rig just down the road.
- ⚙ **What about some free gas for the house on the property?** This could be a good idea – but there may be things more valuable to the Lessor.
- ⚙ **Is there an arbitration clause requiring three arbitrators and a unanimous decision? If so, how can anything be decided when Lessee appoints one of the arbitrators, Lessor appoints another, and those two cannot agree?** In that instance, a stalemate seems likely.
- ⚙ **Are there other risks to mediation and arbitration?** A major risk is the possibility of some other party involved who is not required by contract to arbitrate; meaning at least two separate proceedings will be required – possibly with conflicting results.

These are a few of the issues to be addressed. Note that changes to lease language do not come easily. The person with front line responsibility to negotiate for the Lessee will have limited authority to make many changes, so count on delays if he or she must consult with higher ups.

Oil and gas leases are usually very complex and rarely formulaic. Negotiating oil and gas lease provisions is likely to take patience and tenacity. Seeking counsel before you sign a lease is a prudent decision.



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Highlights of the Federal Housing and Economic Recovery Act of 2008

By Lisa M. Gaiser, Esq.

On July 30, 2008, President Bush signed the Federal Housing and Economic Recovery Act of 2008 which strengthened the regulation of government backed enterprises Fannie Mae, Freddie Mac, and the Federal Home Loan Banks; provided measures to help at least 400,000 families avoid foreclosure; and established tax incentives for home owners. We have prepared an overview of some of the more notable features of the Act.

The Federal Housing Finance Regulatory Reform Act

The Federal Housing Finance Regulatory Reform Act establishes a new and independent regulator for Fannie Mae, Freddie Mac and the Federal Home Loan Banks. The Act gives power to ensure sound operations of government-sponsored entities (GSEs), including the power to:

- Establish capital standards;
- Establish prudent management standards;
- Enforce orders through cease and desist authority, penalties, and authority to remove directors and officers;
- Restrict asset growth and capital distributions for undercapitalized institutions;
- Put a regulated entity into receivership; and
- Review and approve new product offerings.

The HOPE for Homeowners Act

The HOPE for Homeowners Act will make it possible for certain homeowners to refinance their existing mortgages with a 30 year, fixed-rate FHA loan of up to 90% of their home's value. The conditions of the HOPE for Homeowners act are:

- Eligible homeowners are those who originated their loans before January 1, 2008, spend more than 31% of their monthly income on their mortgage, and are currently in danger of foreclosure.
- The program is completely voluntary. Your bank

may elect not to participate.

- If you sell your home after you refinance, you will have to split the equity earnings with the FHA, on a sliding scale basis.
- The program is authorized to insure up to \$300 billion in mortgages and is expected to serve approximately 400,000 homeowners.
- The program begins on October 1, 2008 and ends in September, 2011.

Credit for first time home buyers

First time homebuyers will be eligible for a tax credit of 10% of the purchase price, up to \$7,500. This break will be available for purchases made from April 9, 2008 to July 1, 2009. The homebuyer must repay the credit over a 15 year period, so it is actually more of an interest-free loan than a true tax credit.

Federal Tax Deduction for all homeowners

The standard deduction in 2008 is \$10,900 for married couples filing jointly or \$5,450 for singles. The Housing and Economic Recovery Act of 2008 will create an additional standard deduction of either 100% of state and local property taxes or \$500 for single filers and \$1000 for married taxpayers who own their homes, whichever is less. Historically, there has not been a deduction for state and local property tax paid for people who do not itemize their tax deductions.

Ramification for owners of vacation homes or rental homes

The Act does make a change adversely affecting owners of vacation or rental properties. Previously, if you owned a second home that you planned to make your primary residence at a later date, you needed to live in it as a principal residence for two years in order to qualify for the \$250,000 (\$500,000 for couples) capital gains tax exclusion. Under the Act, the exclusion is pro-rated taking the time the home is used as a primary residence from the total length of ownership. This is effective in January 2009.

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Illustrative example

Before Housing and Economic Recovery Act

A couple buys a vacation home for \$200,000 and rents it for 10 years. They move into the home and make it their primary residence for 15 years and then decide to sell it for \$700,000. The couple can exclude their entire gain - \$500,000 - from their income.

After Housing and Economic Recovery Act

A couple buys a vacation home after January 2009 for \$200,000 and rent it for 10 years. They move into the home and make it their primary residence for 15 years and then decide to sell for \$700,000. They can only exclude 60% of the gain (15 years / 25 years) or \$300,000 from their income.

The entire Act is over 600 pages and it would be impossible for us to review all the ramifications of this legislation here. But we want to make you aware that there are provisions that will affect real estate investors and developers, including extensive reforms related to Real Estate Investment Trusts (REITs); an expansion of some low-income housing credits; and a simplification of rules of tax-exempt housing bonds. You may want to consult with your Rothman Gordon attorney or CPA for more details on how this legislation will affect you.



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