

Client Alert

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The U.S. Shale Gas Industry and Associated Legal Issues

The U.S. Shale Gas Industry

As the price of oil and gas has risen in both the U.S. and around the world in recent years, public pressure has mounted to reduce the country's dependence on foreign energy. This, combined with its own few non-renewable energy reserves, has caused many U.S. energy companies to set their sights on "unconventional" domestic energy sources, particularly shale play gas formations. A shale play is an underground geologic formation formed over millions of years from organic material in ancient sea beds and swamps. Shale gas is natural gas stored within this rock.

With a breakthrough in technology in the 1990s that made production of gas from shale plays more feasible, today, many domestic and foreign oil and gas companies are making large investments in this segment in the U.S.

Legal Issues Relating to the Shale Gas Industry

The emergence of shale plays has sparked a rush by companies to secure rights in areas that may be suited for production of shale gas. This has resulted in significant acquisition and divestiture activity. In some cases, companies have acquired all or a substantial undivided part of a seller's entire acreage. More commonly, however, companies have favored joint exploration agreements and farmouts where the buyer agrees to carry a certain portion of the costs to develop the shale play. In joint exploration and farmout arrangements, issues such as non-solicitation, non-compete and standstill obligations are often some of the most important negotiating items. Similarly, where a seller is retaining formations at deeper or shallower depths, it is also critical that transaction documents contain detailed descriptions of the retained and conveyed depths.

Parts of some significant emerging shale plays are located within densely populated urban areas. As a result, companies wishing to take advantage of these opportunities need to be aware of the interests of surface owners, interactions with the federal, state and local governments, and potential exposure to liability caused by new urban drilling technologies.

Pipeline issues are also important in shale plays. Unlike established production areas, there may be no or a limited number of pipeline facilities serving emerging shale plays. In such cases, it is critical for investors to be able to organize greenfield pipelines or to negotiate acceptable transportation agreements. A careful consideration of the regulatory scheme governing gas pipelines in the U.S. is also necessary.

Another issue for investors in shale plays to be aware of is the ability of certain states to pool tracts into compulsory spacing units even if opposed by one or more mineral owners. In some states, for example, legislation allows the relevant government authority to force separately owned interests

overlying a common reservoir to create a pooled unit if one mineral interest owner makes a fair and reasonable offer to pool and another owner rejects the offer.

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