

The infrastructure boom in eastern Ohio's shale play

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With the ongoing development of the Marcellus and Utica shale plays in eastern Ohio, the oil and gas industry will be installing thousands of miles of pipelines to transport natural gas and natural gas liquids to processing facilities and ultimately to market. Landowners whose property is on a pipeline route will likely be approached to negotiate and sign a pipeline easement or right of way agreement allowing for the use of the property to install and maintain the pipeline(s). While pipeline construction will occur primarily in eastern Ohio, interstate pipelines running to out-of-state destinations could affect landowners in other parts of Ohio as well.

The form right of way agreements prepared by pipeline companies are typically brief 1-3 page documents granting maximum leeway in the construction and maintenance of the pipeline while providing little in the way of landowner protections. The payment terms initially offered are also often far less than the amount that can be negotiated. Signing a bad right of way agreement could burden a property's use and development for years to come, with little financial benefit to the landowner.

Although seeking the advice of an experienced oil and gas attorney is highly recommended, here is a short list of key landowner considerations in the event you are approached about a pipeline right of way agreement:

Number, Size and Location of Pipelines

You should determine early in the process how many pipelines the operator wants to install, the maximum diameter of the pipe, and the route across the property. Demand to see a map very early in the negotiations, and alert the company immediately if there is an issue with the proposed route. Ultimately, the final right of way agreement should incorporate as detailed of a map or survey as possible.

Payment Terms

How is the pipeline operator proposing to compensate you for the easement? By the linear foot? By the acre? If more than one pipeline is proposed, is the operator offering a lump-sum payment up front, or will payments be made periodically as the pipelines are completed? Check with your neighbors and others in the area to determine the "market rate." Perhaps most importantly, if the agreement provides for the installation of multiple pipelines, make sure that you request at least some portion of the per pipeline payment as close to signing as possible. Otherwise, the agreement functions as a lengthy option.

Limits on Construction

You should negotiate firm limits on the amount of time the operator will have to construct the pipeline. If more than one pipeline is proposed, the operator should be required to install the pipelines within a set period of time, and forego the uninstalled pipelines if it does not meet the deadline. For example, if the agreement allows for a maximum of three (3) pipelines to be installed, then the company has five (5) years to do so. If only two (2) pipelines have been installed on the property at the end of the five (5) years, then that is all that can be installed. In addition, does the operator intend to install any above-ground facilities to serve the pipeline?

Damage to Property

How is the operator proposing to pay for actual damage to your property that occurs during and after construction (e.g., by estimating damage up front or paying you as damage occurs)? How will the value of the damage be determined? If you have crop

lands along the pipeline route, the operator should pay you the market value of the crops. If you have marketable timber that will be impacted, the operator should either pay you the market value of the timber or stack the timber for you to sell.

Restoration

After construction, your property should be restored to its previous condition. Are there unique features on your property that need to be explicitly addressed in the easement agreement to ensure restoration is properly completed? Does the company have a land operations worksheet that focuses on property-specific issues (e.g., seed type, fencing specifications, etc.) or is it dealt with in the actual agreement?

Insurance

The pipeline operator should be required to maintain workers' compensation, commercial general liability, commercial automobile and excess liability insurance throughout the term of the easement agreement in commercially reasonable amounts and offered by reputable insurance providers. If possible, you should be included as an additional insured under the operator's policies.

Indemnification

The pipeline operator should fully indemnify you against any claims or liability of any kind resulting from the pipeline operations or the actions of the operator's employees, agents, independent contractors and other affiliated people.

Reservation of Development Rights

You should reserve the right to develop your property in any way that does not interfere with the operation and maintenance of the pipeline. You should consider not just the current use of the property, but potential future uses as the surrounding land is developed.

Abandonment

The easement agreement should terminate if the pipeline is not used for a certain period of time; and the pipeline operator should be required to either remove the pipeline and restore the surface, or cut and cap the pipeline and leave it on your property.

Other Agreements

The pipeline right of way agreement may not be the only item to negotiate. If temporary workspaces or access roads are required along the pipeline route during construction, is the operator offering additional payments for those uses of the property?

Tax Considerations

The structure of your right of way or easement agreement can have a big impact on your tax liability for the payments you receive. For example, payments for a perpetual easement (an easement with no defined expiration date) are treated similarly to payments received for a sale of property, with recovery of basis in the property and excess payments taxed at lower capital gains rates. On the other hand, payments for an easement with a term of less than 30 years will likely be taxed as ordinary income. Payments for damage to your property can also be taxed differently depending on how the damages are classified and whether you can demonstrate to the IRS that actual damages have occurred. Consultation with an experienced oil and gas attorney or tax professional is highly recommended to ensure you are not surprised by unexpected taxes.

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