Update on Gas Royalties
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By Glen Estes

This article is intended to give you some idea of the order of magnitude of gas royalties you may receive based on <u>my</u> initial royalty payment from Chesapeake. The short answer is "don't expect very much soon!" This first royalty payment was for approximately five months (Sep. 2011 through Jan. 2012). The net payment for my .32 acres in the Wedgwood Unit was only $70.23 This rate would equate to about $44 per month for one acre, $14.50 per month for 1/3 acre, or only $11 per month for a 1/4 acre lease. I assume that royalties for people in the Pear Unit would be comparable when they receive their payments hopefully within a few weeks.

Along with your royalty check, you will receive a detailed statement that identifies the well site, the total production and value each time they gauge the production, and an extension that shows how much of that production and value belongs to you based on your acreage that is leased. Each of the sixteen columns on the report is labeled, but it is still difficult to fully understand the report unless you study it carefully. The form will also show a deduction of approximately 7% for the Texas severance tax. Please note that Chesapeake sends a royalty check only when the amount is $50 or more.

I am by no means an expert on gas royalties, but I have made a concerted effort to educate myself on the subject so I can share the information with you. Here are some facts and my opinions as to where we are and what to expect for the future:

- Fact: The law of supply and demand is definitely working! There is a major over supply of natural gas throughout the US. The technological developments in horizontal drilling and fracking in recent years have led to development of a number of major new natural gas fields in several states to include the huge Eagle Ford field in south Texas.
- Fact: The drastic increase in production in recent years has <u>not</u> been matched by a comparable increase in demand. Therefore, the price has dropped like a rock. The price was over $12 per MCF (1,000 cubic feet) when Candledridge homeowners signed their gas lease in May 2008. Now, four years later, it is only about $2 per MCF.
- Opinion: I believe that the price of natural gas will continue to be very low for several years. That would dictate that our royalties would also be very low for several years.
- Opinion: The current low price for gas gives little or no incentive for Chesapeake to drill additional wells in the near future. (Originally, five wells were projected for the Pear Unit and five for the Wedgewood Unit.) Currently each unit has only one well.
- Opinion: The current low price also gives Chesapeake no incentive to maximize production. In fact, it gives them incentive to limit production and save the gas to sell at a later time at a much higher price.

- Opinion: There is currently a great disparity in price between crude oil and refined gasoline compared to natural gas. This disparity is likely to continue for several years. It will create great investment opportunities and stimulate development of ways to effectively use the cheaper natural gas as a replacement for other energy sources. When this ultimately happens, the price of natural gas will significantly increase and thereby provide incentive for Chesapeake to drill additional wells and maximize production at existing wells.
- Conclusion: Candleridge gas lease holders will receive extremely small royalties for the next several years, likely for even five years. Then, in the next six to ten years, I believe prices will greatly increase, drilling will increase, production will increase, and royalties will greatly increase. Instead of receiving royalties for one well with gas selling for $2 per MCF, you may be receiving royalties on four or five wells with gas selling for $8, $10, or even $12 per MCF. I believe that is a distinct possibility.

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