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## Frequently Asked Questions about Oil & Gas Leasing and Production in North Carolina: What Every Landowner Should Know

Attribution: North Carolina Cooperative Extension Service with adaptations by the staff of the Office of the Secretary of State and the North Carolina State Geologist

### **Disclaimer:**

The following is provided for informational purposes only and should not be construed as legal advice or guidance. Individuals should always obtain an attorney who is licensed to practice in North Carolina whenever signing a contract or lease in North Carolina. The Information herein is based on best practices in North Carolina and other states. While every effort has been made to provide up-to-date information laws and technology change rapidly and anyone considering leasing their property for oil or gas production must do their own due diligence.

### **Mineral Rights**

Question:

If I own the surface rights to my property, do I own the mineral rights also?

Answer:

The owner of the surface rights may or may not own the mineral rights as well. At some point in the past the mineral rights may have been severed from the surface rights and sold — and the records of these transactions may be difficult to find through a mineral rights title search. The surface rights owner then may be unaware that the mineral rights are held by another owner who may have been paying property taxes on these rights over time. For this reason, it is important to obtain the advice of a North Carolina licensed attorney experienced with conducting mineral rights title searches before ever considering warranting the title to these rights. There are risks with warranting the title to rights that the owner must understand, which may include being liable to the leasing company and the actual owner of the rights should it be determined that the title is not clear. The company leasing the land for exploration and production is likely to be better able to bear the risk of a defective title than the landowner.

### **Surface Rights**

Question:

If I own the surface rights, but not the mineral rights, can someone use my property to drill for natural gas and/or oil?

Answer:

Yes. A company leasing the rights to natural gas, oil, or other minerals is allowed to use the surface, in a non-negligent manner, to extract these resources. A drilling operation may require the modification or displacement of structures or other surface features on a tract of land, and the drilling company and/or company leasing the mineral rights may or may not be required to restore the surface to its original

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condition. The terms of the lease agreement will determine whether the leasing company will be required (absent negligence) to restore or make payment for damage to surface structures, as well as whether the owner of the surface rights is a beneficiary of the lease agreement. The mineral rights holder may or may not be required to pay for surface damages depending on the terms of the lease.

## Legal Representation

Question:

Should I consult an attorney before I lease my property for oil and gas exploration and production?

Answer:

Yes. To protect your property rights and your property, and to ensure that you achieve the maximum income benefit from a lease allowing for production of gas, oil, or other products from your parcel, you should always consult a North Carolina licensed attorney with experience in natural gas and/or oil leases. The landowner should establish and understand all fees that will be charged by an attorney and all services that will be performed in return. You should have a written contract (retainer agreement) with your attorney that sets this information out in a clear and understandable fashion. Signing a lease without consulting an attorney can result in lease provisions unfavorable to the owner, and reduced compensation — and can expose the owner to unexpected costs and liabilities associated with exploration for and extraction of mineral resources on your property. In addition, the owner may be subject to liability, fines, and other costs that result from lease terms favoring the entity leasing your rights. The North Carolina Bar Association has a free lawyer referral service that can be reached at 1-800-662-7660 (in-state) or 919-677-8574 (out-of-state and in the Raleigh calling area). Details can be found at [www.ncbar.org/public-pro-bono/lawyer-referral-service/for-the-public.aspx](http://www.ncbar.org/public-pro-bono/lawyer-referral-service/for-the-public.aspx).

## Communication with Attorney

Question:

If I am a mineral rights owner, how involved should I be in the lease negotiation?

Answer:

If you are a mineral rights owner, you should be involved in all aspects of the lease negotiation to make sure your needs and rights are addressed. It is very important that you communicate your positions to your attorney as a lease is negotiated with regards to terms of the lease including compensation — and that these are all addressed in the lease. You and your attorney should review the lease in its entirety before signing it to ensure that all terms are met. Additionally, you should consult with an attorney experienced in natural gas or oil leasing, and give thought to modifying the terms of the lease agreement, if necessary, to meet the leasing company's terms as well.

## Registration and Licensing of Leasing Agents in North Carolina

Question:

What qualifications and requirements should I look for in a company or leasing agent to which I may lease my mineral rights?

Answer:

Companies that transact business in North Carolina should be registered with the North Carolina Secretary of State's office. Additionally, there may be a requirement that the broker or agent who is acting as an intermediary between the company leasing the rights and the mineral right's owner be

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licensed by the North Carolina Real Estate Commission. You should ask if the company is registered to transact business in North Carolina and should then verify this information by calling the Corporations Division of the North Carolina Department of the Secretary of State at 1- 888-246-7636 or 1-919-807-2225. Information is also available online at [www.secretary.state.nc.us/corporations](http://www.secretary.state.nc.us/corporations). The fact that a company is not registered with the Corporations Division should be taken as a warning sign that additional information is needed before you conduct business with that company. In addition, any leasing agent, whether an employee of the leasing company or of a third company, who receives either extra compensation (i.e., a bonus) or a commission for such activity, must be licensed by the North Carolina Real Estate Commission. To verify that the leasing agent is properly licensed, you may contact the Commission at 1-919-875-3700 or by going online at [www.ncrec.state.nc.us](http://www.ncrec.state.nc.us). You should also contact the Better Business Bureau at [www.bbb.org/us/](http://www.bbb.org/us/) to check out a company's background before signing a lease agreement. There are also for-profit companies which provide business reports for a fee. Public companies' financial information can be found on the U.S. Securities and Exchange Commission website at [www.sec.gov/edgar/searchedgar/webusers.htm](http://www.sec.gov/edgar/searchedgar/webusers.htm).

## Methods for Extracting Gas and Oil in North Carolina

Question:

What drilling and extraction methods used to extract natural gas are legal in North Carolina?

Answer:

Two of the technologies required to maximize the extraction of natural gas in North Carolina (1) horizontal drilling and (2) fracturing ("fracking") are not currently allowed under North Carolina law. At this time, the only legal extraction method in North Carolina is vertical well drilling. This is authorized by Chapter 113, Article 27 of the North Carolina General Statutes. Rules for drilling, completion or abandonment, and development of wells are contained within Title 15A, Chapter 5, Subchapter D of the North Carolina Administrative Code. Regulations are enforced by the North Carolina Geological Survey office of the North Carolina Department of Environment and Natural Resources, which may be contacted at (919) 733-2423, ext. 401. If the law in North Carolina were to change at some point, the value of the rights to extract natural gas could increase depending on other market factors.

## Natural Gas and Oil Production

Question:

What are drilling and production units?

Answer:

Resources like natural gas and oil form underground reservoirs, which can underlie the surface holdings of many tracts of land. Exploratory drilling will be conducted prior to drilling, and natural gas or oil may be found in these exploratory wells, also referred to as test wells. However, the location of these test wells may not be at the best location over a reservoir for actual extraction and production of natural gas and oil. To ensure adequate production, and spacing between wells so that one well does not drain all of the resource from areas held by other subsurface mineral rights owners, drilling units, also called production units, are formed. A *drilling unit* is an area of size specified and created by the North Carolina Department of Environment and Natural Resources (the Department) upon which drilling for production may occur. Drilling units may include one or more parcels of land and are created to prevent the wasting of gas and oil during extraction. The formation of these units is also referred to as a "pooling of owners" or "unitization of tracts." A drilling unit can be established over a single reservoir of

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natural gas or oil, or a reservoir may be divided up into zones — and a drilling unit may then be created for each zone. Like a drilling unit, the Department can determine the number of zones that may be established as well as the size of those zones. These drilling units, and zones, serve to limit the number of wells drilled, thereby limiting risks associated with excessive drilling. If a landowner is part of a unit, then their royalty payment will correspond to the percentage that their mineral rights comprise of that unit. If a tract of land is not large enough to comprise a unit, it is usually necessary to include additional mineral rights owners in the same area to form a unit before a company will lease those rights. In some circumstances a landowner may be included in a unit even if they still do not lease their mineral rights. They should, however, be compensated accordingly based on the percentage of the mineral rights they own that are part of the drilling or production unit.

## Compensation

Question:

What type of compensation would I receive for allowing someone to extract natural gas and/or oil from my property, if I have mineral rights?

Answer:

Whether a landowner will be compensated will depend on whether the landowner owns the mineral rights — and, if the rights are separate, whether the surface rights holder must be compensated either by the terms of a lease or by law . For surface rights-only owners, please refer to the “Surface Rights” section of this document. There are two types of compensation a landowner can receive. The first is what is referred to as “bonus” money, which is paid to the landowner by an energy company for the right to drill and extract natural gas from their property. This is paid per acre of mineral rights leased and it gives the company the right to conduct exploratory activities, including well drilling, as well as the construction of wells for the production of natural gas and oil. The second form of compensation is a royalty, which is a percentage of the profit made from the sale of natural gas that is actually extracted from the property and sold. If there is more than one mineral rights owner, this royalty will be divided among all of the owners of the mineral interests in a unitized production area that has been leased. Both bonuses and royalty percentages may vary due to many factors, including the number of wells that have already been drilled and the current or expected future demand for natural gas at the time a lease is signed. In some states, like Louisiana, it is not uncommon for leases to be signed for thousands of dollars per acre in bonus money in one month, and the next month leases may be worth much less. Landowners should take time to consider whether it is to their advantage to sign a lease now or wait to see if factors change in the future that will allow them to maximize the compensation they receive. Compensation should also be provided to the owner of the surface rights for damages to crops, trees, structures, or other assets due to site clearing and construction for all aspects of the production operation. This includes the building of roads, the clearing of drilling sites, and for pipeline right-of-ways. This compensation is normally separate from bonus monies and royalties paid to the mineral rights owner.

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## Warranty of Title

Question:

Should I warrant the title to my property when leasing or selling mineral rights in North Carolina?

Answer:

Landowners may not be completely certain that the mineral rights were never severed from a parcel's surface rights. Because of the length of time that many titles go back in North Carolina, it may be extremely difficult to search a title in such a way that a property owner can warrant the title to be absolutely free and clear of any other interests in either the surface or mineral rights. An owner should never considering warranting the title to their property without obtaining the advice of a North Carolina licensed attorney experienced in both land and mineral title searches.

## Term of Lease

Question:

What is an acceptable period of time that should be included in the lease that will allow for natural gas and/or oil exploration and extraction on my property?

Answer:

Any period of time may be included in a lease. However, the owner of the mineral rights should understand that market forces always change, and that such forces will affect the price paid. For example, a lease signed when the demand for natural gas is high may allow for a larger bonus money amount per acre – and a greater percentage of royalty in the lease. Conversely, if demand for natural gas is low, or drilling companies have already signed leases for most of the areas they need for drilling, then the bonus money paid and royalty percentage could be much lower. Thus, prices for a mineral may change, negatively or positively, over the period of the lease. If a mineral rights owner expects that the price may go down within a certain period time he or she may want to offer a shorter lease to ensure that extraction of the minerals is done within a shorter time period. In states like Louisiana and Texas, where gas and oil have been produced for over a century, these leases tend to be around 3 years. If drilling does not start within the full time period covered by the lease, including grace and renewal periods, then the landowner may seek another entity to lease his or her rights. However, a company may exercise its lease rights at any time during the period covered by the lease, including the last day – and if the lease agreement provides for it ten years or more to drill and extract minerals from a parcel the leasing company can legally take ten years to engage in this activity. A long-term lease may also affect what may be done on the surface of the parcel because of the uncertainty of when or where wells will be drilled, and gas pumping and pipeline infrastructure will be constructed. Rights-of-ways and buffers for this infrastructure, to ensure the protection of the equipment and the safety of those around it, will create a larger undevelopable footprint than the actual infrastructure itself. Leases are usually divided into phases. During the first phase, the leasing company will secure the necessary permits, conduct some exploratory drilling, build infrastructure and conduct other activities necessary to extract natural gas or oil. A grace period may be added to the first phase of the lease agreement so that if permits are not secured, or other circumstances do not allow for drilling (e.g., “acts of God”), extra time is allowed to create a commercially productive well. For example, a lease with a term of 3 years may provide for a grace period of 3 additional years. This allows for phase one to be a total of 6 years. The second phase may begin at the end of the first phase when a well has been drilled that is producing a natural gas or oil in paying quantities — or if the leasing company is engaged in

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efforts to begin or restore production of natural gas or oil within the area being leased. However, depending on the terms of the lease agreement, a leasing company may extend the agreement into a second phase of some number of years even if there is no commercial production, or any activity on the part of the leasing company that would allow for commercial production. This may occur if an additional bonus payment is made to the mineral rights owner.

The terms of the lease will determine the length of phase two and can vary from lease to lease. Some leases may state that the second term will remain in effect for as long as a well continues to be commercially productive. Alternatively, a lease may state that the second phase continues for as long as any amount of gas or oil is produced —or for as long as operations are conducted, but the production of gas or oil is not required. The mineral rights owner and his or her attorney need to carefully examine the duration of the lease agreement and all conditions under which a phase of a lease may commence and be extended. The lease agreement should allow the mineral rights owner to release his or her rights once the total time period of the first phase has expired if it has not transitioned to the second phase, or when the second phase has expired. However, usually included in the lease is a right of first refusal provision that allows the leasing company to match a bona fide offer from another company after the original lease agreement terminates. This provision allows a landowner to solicit better offers from other companies while giving the leasing company the ability to protect its investments such as the roads and other infrastructure that have been constructed already.

### Water Usage

Question:

How much water is required for a drilling operation and where will it come from?

Answer:

Water for the drilling, and fracturing if legalized by the North Carolina General Assembly, could be on the low end of maybe 250,000 gallons to a high end of perhaps several million gallons and it may be recycled and reused for these processes. This water may come from the surface or from underground. If possible, it is preferable to use water from a source other than the property being drilled. However, if it is necessary to remove water from the same tract, the lease agreement should state whether the leasing company has the right to drill and extract water from the unit where it is drilling — and it must provide for what protections will be put in place to protect the water quality of surface and groundwater from the construction and operation of these wells. The lease agreement should specify that the usage of this water for drilling and extraction operations will not affect the availability or quality of water for other purposes, including personal consumption, or for growing crops or raising livestock.

### Warranty of Title to Water Rights

Question:

Should I warrant the right to use water on a property in a lease?

Answer:

Mineral rights and surface rights owners should never warrant to the leasing company the right to use surface or groundwater on a property without first consulting with a North Carolina licensed attorney

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experienced in water rights. It is possible that the water rights, either above or below the surface, could be deeded to an owner other than those that own the surface and mineral rights for that same tract of land. The lease agreement should require the leasing company to cover the costs of determining who owns the rights to the water that will be used in the drilling operation, as well as the costs of leasing or purchasing those water rights. The lease agreement should address who will be responsible for obtaining and paying the cost of any permits from any governmental agency for the proposed water use.

## **Indemnification/Hold Harmless from Liability and Environmental Considerations**

Question:

What potential liabilities should I consider before I lease the mineral rights on my property?

Answer:

There are many liability issues you should consider in consultation with your attorney. These liabilities include, but are not limited to, the potential contamination of water and soil from drilling wastes. The lease should specify that the energy company is responsible for obtaining and disposing of water and drilling muds used in drilling operations in a way that meets all local, state, and federal laws and regulations. Drilling for natural gas and oil can involve the use of large amounts of water and chemicals to fracture the rock underground in order to release these resources and force them to the surface for extraction. These materials must be used and disposed of in accordance with all local, state, and federal laws and regulations. If these materials are not handled properly and according to regulations, ground contamination and surface and underground water contamination in the area drilled may result. Additionally, neighboring underground drinking water supplies may also become contaminated. This may in turn lead to civil suits from neighboring landowners and enforcement actions against the mineral rights owner by regulatory agencies.

The mineral rights owner should ensure that an indemnification clause is included in the lease that will hold him or her harmless for all liability associated with drilling and its accompanying activities. The indemnification clause should require the drilling company and/or the energy company leasing the rights to bear the costs of defending against all civil actions. The company should also be required to bear all the costs for complying with all applicable rules and regulations – as well as those resulting from noncompliance.

## **Local Regulations**

Question:

Are there local land use regulations in North Carolina, which may apply to oil and natural gas operations?

Answer:

Natural gas and oil operations are uses that can be regulated under local land use regulations such as county and municipal zoning ordinances. These uses must be included within a zoning ordinance for them to be allowed, and must be conducted in accordance with all ordinance requirements if they are allowed, or the owner of the property is in violation of the ordinance. The owner(s) may face fines and other penalties for ordinance violations. The mineral rights owner should ensure that the lease agreement require the leasing company to abide by all local, state, and federal laws and regulations — and that the leasing company will cover all costs of compliance with, or violations of, all applicable rules

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and regulations. See also the section “Indemnification/Hold Harmless from Liability and Environmental Considerations.”

## Additional Expenses

Question:

What are additional expenses associated with drilling that should be considered in the lease?

Answer:

Additional costs to consider include those associated with securing the drilling site, the handling of materials and wastes associated with drilling, and site restoration. There are additional cost considerations that will be specific to each individual property and each mineral rights owner’s circumstances. All of these should be considered and addressed appropriately in the lease, which should be reviewed by an experienced attorney, before it is signed.

The lease should be written so that you both the surface owner and mineral rights owner are not responsible for any costs associated with the storage, transport, clean-up, or disposal of drilling wastes, equipment, or any other material associated with the drilling and extraction of natural gas or oil. Finally, the landowner may want to include a provision in the lease agreement requiring the leasing company to pay the costs associated with clearing the site for drilling and pipeline infrastructure, as well as those associated with fencing off the drilling infrastructure and materials. It is important that all drilling equipment, wells, pumps, pipelines, and other infrastructure be fenced in to exclude not only people, but also livestock, to prevent injury and death or damage to equipment. Additional costs may include vegetation buffers or other means of shielding pumps or pipelines under land use regulation visual buffer requirements, if applicable. Finally, the lease agreement should specify what will be required of the leasing company to restore the site to pre-drilling and extraction conditions. This includes proper closure of wells, provisions for shut-in wells and production wells, the removal of all equipment and materials used in the operation, replanting of vegetation, and whatever else may be required to restore the site to its original conditions.

## Present-Use Value Tax Program

Question:

Can leasing my land for gas exploration affect my continued participation in the present-use value tax program?

Answer:

Yes. Property tax is based on the highest and best use of the real property unless it qualifies for participation in the present-use value tax program. Gas exploration activities may result in loss of participation in the present-use value tax program for all or part of your land. This may be due to several factors including, but not limited to, a reduction in the amount of acreage required to remain enrolled or a change in the type of income generated from a property. For example, if a road is built through your property to reach a well, which takes an acre of land away from a twenty acre tract, this would result in a landowner no longer meeting the twenty-acre minimum required under state law. If you lose your present-use value status, you may be required to pay additional property taxes in the current year as well as three years of back taxes. Your lease agreement should include a provision to compensate you for the payment of back taxes and any other expenses incurred as a result of your

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property losing its present-use value status. The lease should require the leasing company to pay for attorneys fees associated with any appeals of county tax assessor decisions.

### **Impact on USDA and State Farm and Forestland Programs and Benefits**

Question:

What affect could natural gas and/or oil exploration or production have on my federal price support program, federal and state cost-share program, and other benefits?

Answer:

You may forfeit federal price support and other program benefits if there are violations of Highly Erodible Land Conservation and Wetland Conservation Compliance provisions (Swampbuster) on your land. Additional penalties may include the requirement for immediate repayment of Farm Service Agency or other United States Department of Agriculture loans —and the repayment of funds received from federal cost-share programs. You may also be ineligible in the future for insured or guaranteed loans, disaster relief, crop insurance, conservation and environmental easement payments — and participation in watershed protection and flood prevention projects. Additionally, any activities conducted in areas under conservation reserve program easements that violate federal laws and regulations and/or the terms of easements may result in repayment of funds received for those easements. Loss of program benefits and repayment of cost-share monies received from state programs may also be required. Any landowner with land enrolled in federal and state programs is solely responsible for ensuring that all activities on his or her land comply with all federal and state laws and regulations. It is the landowner that will lose program benefits and have to address repayment of loans, and possible payments of fines, not the leasing company if laws or easement conditions are violated. Detailed property Information, including maps, delineations, and surveys, pertaining to areas of areas of your land that are enrolled in any federal or state program, should be attached to the lease —and the terms of the lease should prohibit any activity on the part of the leasing company in these areas. The landowner may wish to include an indemnification provision covering losses associated with the loss of farm program benefits and legal expenses associated for defending against allegations of violations.

### **Affinity Fraud**

Question:

What is affinity fraud?

Answer:

Affinity fraud is fraud directed against members of a group sharing a common characteristic, like belonging to the same ethnic or religious group, being retirees or senior citizens, having the same career or occupation, or engaging in the same community activity. Con artists realize that people tend to trust other members of their group more than they trust outsiders. This is why a key tactic in affinity fraud is to use references from a few people within a group to persuade other members to part with their money. Once the crook has sold a few high-profile members on the investment scheme, their names can be used to dispel others' skepticism or doubt. Group members often unknowingly aid the con artist by persuading unsuspecting friends or family members to get in on the "deal." One way to protect yourself from falling victim to affinity fraud is to remove emotion from what is essentially a business decision. Do not let emotional appeals sway you into making a hasty decision. You should approach all

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investment opportunities in a business-like manner. Exercise the same caution and skepticism that you would with any other business transactions.

This is not to suggest that every company that uses community leaders to promote its effort is in violation of the law. Such is certainly not the case. Landowners are simply advised to be aware of such tactics and to exercise caution and due diligence.

## Fraud

Question:

What are the warning signs of a potential investment fraud?

Answer:

Financial criminals may be among the smartest people we will ever meet. The “successful” con artist is a marketing expert who understands human nature, and preys upon our fears or desires by unleashing a variety of psychological tactics against us, hoping to find the right combination that will get us to lower our natural defenses and give him what he wants – our money! The key, then, to avoid becoming an investment fraud victim is to recognize the pressure tactics and remember that it is OK to say “NO” to an unsolicited sales pitch. Although not complete, here are the most common psychological tactics con artists employ against their victims:

- Promises of Wealth – The salesperson dangles the promise of wealth in a short period of time, often “guaranteed” with “little or no risk” involved. Remember: All investments carry risk.
- Trappings of Success – The salesperson projects the image of success or offers testimonials, “proving” he and the offer are “legitimate.” Remember: Credibility can be faked.
- The “Lemming” Effect – The salesperson tells you that others are investing and that you should too or risk losing out on a good deal. Remember: If everyone jumped off a cliff, would you?
- Favors – The salesperson gives you something (like a free meal or a discount) hoping you will feel obligated to give him something in return (like your money). Remember: You have no obligation to return any business-related favor.
- Act Now – The salesperson pressures you to “act fast” because the offer will only be available “for a limited time.” Remember: Do not feel pressured to make a quick investment decision.

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## Reporting Fraud

Question:

How do I report suspected fraud?

Answer:

If the suspected fraud involves the offer, sale or purchase of investment securities, contact the Securities Division of the North Carolina Department of the Secretary of State. The term “securities” encompasses many different types of financial products. These can include stocks, bonds, certificates of interest or participation in an oil, gas, or mining title or lease, or in payments out of production under a title or lease, or investment contracts. You may call the Securities Division at 1-800-688-4507 or 1-919-733-3924. With limited exceptions, anyone engaged in the offer, sale, or purchase of investment securities must be registered with the Securities Division in order to lawfully conduct business in North Carolina. In addition, the investment security itself generally must be registered with the Securities Division before it can be offered in North Carolina. More information can be found at [www.sosnc.com](http://www.sosnc.com). For all other types of fraud, contact the NC Department of Justice at 1-877-566-7226 or go to <http://ncdoj.gov>.

## Resources

For more information, contact:

NC Department of the Secretary of State ([www.sosnc.com](http://www.sosnc.com))  
Corporations Division: (919) 807-2225 or (888) 246-7636  
Securities Division: (919) 733-3924 or (800) 688-4507

NC Geological Survey: (919) 733-2423 or [www.geology.enr.state.nc.us](http://www.geology.enr.state.nc.us)

NC Cooperative Extension Service: (919) 515-5195 or  
[www.ag-econ.ncsu.edu/gasleasing.html](http://www.ag-econ.ncsu.edu/gasleasing.html)

NC Real Estate Commission: (919) 875-3700 or [www.ncrec.state.nc.us](http://www.ncrec.state.nc.us)

NC Department of Justice: (919) 716-6400 or (877) 566-7226 or [www.ncdoj.gov](http://www.ncdoj.gov)

NC Bar Association: (919) 677-8574 or (800) 662-7660 or [www.ncbar.org](http://www.ncbar.org)

Better Business Bureau of Eastern North Carolina: (919) 277-4222 or <http://easternnc.bbb.org>

For definitions of oilfield terminology, please consult Schlumberger’s Oilfield Glossary at [www.glossary.oilfield.slb.com](http://www.glossary.oilfield.slb.com).