

**MEETING OF THE COMPULSORY POOLING STUDY GROUP
NORTH CAROLINA MINING AND ENERGY COMMISSION
MARCH 1, 2013
CENTRAL CAROLINA COMMUNITY COLLEGE
MULTI-PURPOSE ROOM, BUILDING 42, 764 WEST STREET
PITTSBORO, NORTH CAROLINA**

1. PRELIMINARY MATTERS

Chairman Ray Covington called the meeting of the Compulsory Pooling Study Group of the Mining and Energy Commission (MEC) to order at approximately 9:00 am and read the ethics statement into the record.

Dr. Covington welcomed everyone in attendance. Panel members made up of the MEC Commissioners and the Resource Group members introduced themselves. Dr. Covington noted that Commissioner Womack was absent due to a conflict with an economic development summit in Lee County. The following persons were in attendance for all or part of the meeting:

MEC STUDY GROUP MEMBERS

Dr. Ray Covington
Mr. Charles E. Holbrook
Mr. Ward Lenz in place for the Assistant Secretary of Energy, Department of Commerce

STUDY GROUP RESOURCE MEMBERS

Mr. Nathan Batts, N.C. Bankers Association
Mr. Theodore Feitshans, Department of Agriculture and Resource Economics, NCSU
Mr. John G. Humphrey, the Humphrey Law Firm
Mr. Jonathan Lanier, N.C. Department of Agriculture and Consumer Services
Mr. Don Kovasckitz, Lee County Strategic Services
Mr. Grady McCallie, North Carolina Conservation Network
Mr. James Robinson, Rural Advancement Foundation International (RAFI)
Mr. Spencer Scarboro, State Employees' Credit Union
Ms. Janet Thoren, N.C. Real Estate Commission
Ms. Lynne Weaver, N.C. Attorney General's Office, Consumer Protection Division

DENR STAFF MEMBERS

Ms. Layla Cummings
Ms. Trina Ozer

OTHERS IN ATTENDANCE

See attached sign-in sheets.

2. GETTING TO YES: HOW A COMPULSORY POOLING STATUTE FACILITATES FAIR NEGOTIATIONS AMONG INTEREST HOLDERS

Ms. Brigid Landy, a law clerk in Pennsylvania, gave a presentation on a proposal for compulsory pooling in her state by conference call (see attached article and PowerPoint presentation). The research was conducted while she was a third-year law student at Temple University with co-author and fellow student, Mr. Michael Reese. Ms. Landy stated that her views and the presentation were not legal advice and did not reflect the views of her employer, the Supreme Court of Pennsylvania.

Ms. Landy addressed some of the common arguments and misconceptions surrounding compulsory pooling and explained that it might be advantageous for landowners. Ms. Landy explained the two-prong purpose of pooling as: (1) the prevention of waste and (2) the protection of correlative rights. Pooling prevents waste by maximizing the recovery of gas. Pooling protects correlative rights by protecting each individual property owner's right to produce from a common source of supply.

Ms. Landy reviewed the constitutionality of compulsory pooling. In a case from 1938 called *Patterson v. Stanolind Oil and Gas Company*, the Supreme Court of the United States dismissed an appeal challenging Oklahoma's pooling statute and effectively upheld Oklahoma's use of the state police power to prevent waste through compulsory pooling. Ms. Landy did note that the courts have not specifically addressed horizontal drilling.

Next, Ms. Landy discussed her proposal for cost and profit sharing under a compulsory pooling statute in Pennsylvania. Ms. Landy distinguished two different situations under compulsory pooling statutes: (1) the leased landowner who has already contracted to develop the resource and (2) the unleased landowner, an owner of a mineral estate who has not received compensation. In other states, a landowner may be subject to a free ride statute, a risk penalty statute, or the surrender of working interest option. North Carolina is a free ride statute state, meaning that the landowner who is pooled is not charged a penalty for risk and shares in the royalties after costs if the well produces. Many states take the risk penalty approach, which means that the landowner is carried but must pay a risk penalty, ranging from 150-400% of costs, before receiving royalties from a successful well. The surrender of the working interest approach requires that the mineral interest owner assign his working interest to the drilling party in exchange for a bonus payment, royalties, or both. This approach is similar to signing a lease with the drilling party, but the conservation commission dictates the terms of the lease.

In addition to considering cost and profit sharing, Ms. Landy suggested that states should also consider who may petition to pool, the minimum acreage requirement, and with whom a petition to pool is filed. Ms. Landy noted that Pennsylvania has not adopted a compulsory pooling statute that applies to the Marcellus Shale. However, Pennsylvania Senate Bill 355 was recently introduced to the state legislature to make compulsory pooling legal in the Marcellus Shale. The bill would only allow operators to pool other operators (rather than landowners) and would have a 65% minimum acreage requirement.

Ms. Landy took questions from panel members after her presentation. She was asked about the value of the risk penalty approach and answered that it allows the non-consenting landowners to share in the profits without being responsible for the cost of a dry well. She was also asked about the process of pooling and when a landowner is allowed to choose an option to participate. Ms. Landy answered that the landowner will be sent a notice and allowed to make his or her election at the hearing. Ms. Landy was asked, in her opinion, which type of cost sharing statute provides the best protections for unleased landowners. Ms. Landy said she believed a balanced approach that facilitates negotiation and private contracting is best for all parties involved. Ms. Landy also noted that her proposal for a compulsory pooling statute did not include a minimum acreage requirement because that may disenfranchise the small landowner who wants to petition to join a pool.

3. Consideration of Study Group Recommendation on Surface Use

Chairman Covington read the following policy statement on surface use for the consideration of the Study Group:

“The Commission in ordering pooling of mineral, oil, and gas interests shall not have the authority to grant an operator any rights to the surface property above any mineral, oil, and gas interests compelled into a pool. Any access to surface rights above compelled mineral, oil, and gas interests may be obtained only through negotiation of a voluntary agreement between the operator and the owner of the surface rights, regardless of whether such surface rights are unified with or divided from the underlying mineral, oil, and gas interests.”

It was noted that this language is not an official proposal for statutory or regulatory language, but rather a statement that the Study Group would recommend that surface use be prohibited on land compelled into a drilling unit. Ms. Layla Cummings reviewed the law on surface use in six other states (see attached handout).

After some discussion, the two commissioners present agreed with the policy. A question arose as to whether a quorum was needed to officially pass on a recommendation of the Study Group to the full MEC. A quorum of commissioners was not present at this meeting. Ms. Trina Ozer stated that DENR would consult with Ms. Jennie Hauser of the Attorney General’s Office to determine the procedures necessary for a Study Group to make an official policy recommendation to the MEC.

Mr. James Robinson of RAFI asked whether making this recommendation presupposes that the Study Group has already decided to recommend retaining compulsory pooling as law in North Carolina. Dr. Covington answered that the Study Group has not made that decision and will return to the question after fulfilling its legislative mandate to thoroughly study compulsory pooling.

4. Public Questions and Comments

Dr. Covington addressed written questions from this week and last week. The first question was how House Bill 8 on eminent domain will affect compulsory pooling regulations. Dr. Covington said that since the bill is still being considered in the Senate, the language may change and the Study Group will wait to address it.

The next question concerned who would determine the guidelines for forced pooling. Dr. Covington said Senate Bill 820 is clear that the Study Group will make recommendations to the MEC and then, the MEC or DENR will report back to the General Assembly. It is not clear how the process is different for legislation versus regulations and rulemaking. The Attorney General's Office will be consulted regarding the different procedures for legislation and regulations.

There was a question concerning how compulsory pooling will affect mortgages and whether mortgage holders can be held in breach of their contract for mining activities if they are force pooled. Ms. Lynne Weaver of the Attorney General's Office addressed the question and said that it would be difficult for the borrower to be held in breach if he or she did not actually take an action in breach of their contract. However, if the borrower signs a lease for oil and gas development, that would be a different scenario and breach is possible. If the state offered options for voluntary pooling, it could potentially create a legal grey area.

The next question concerned conflicts of interest in the Study Group. Dr. Covington referred the audience to the state's Ethics Commission website where there is a definition of conflict of interest and stated that a complaint of possible self-dealing can be made to the Ethics Commission.

The last question was a two-part question. First, the individual asked whether under existing law, a landowner can be forced into a pool if voluntary negotiations fail. Second, the individual asked whether it is advisable for landowners to sign leases now. Dr. Covington answered that the landowner may be force pooled under existing law, and he stated that it is not advisable to sign leases at the present time.

The meeting was adjourned at approximately 12:00 pm.

DEMLR Staff Contact for this Study Group: Walt Haven, Energy Program Supervisor, Land Quality Section.