Compulsory Pooling & Landowner Protections

Presentation to Compulsory Pooling Study Group of the North Caroling Mining & Energy Commission

McSwain Agriculture Center
Sanford, NC
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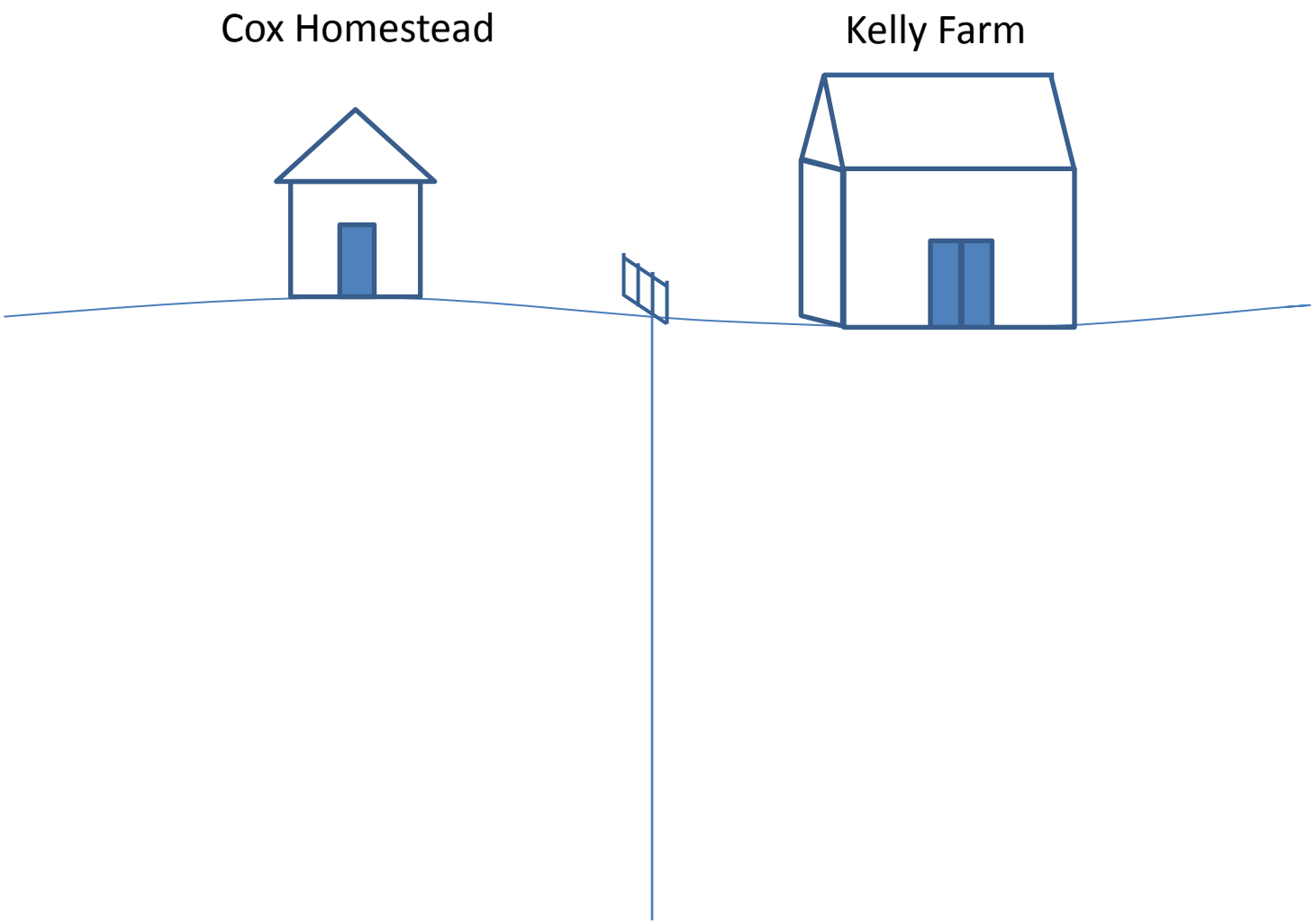
Unitization and pooling of leased mineral estates



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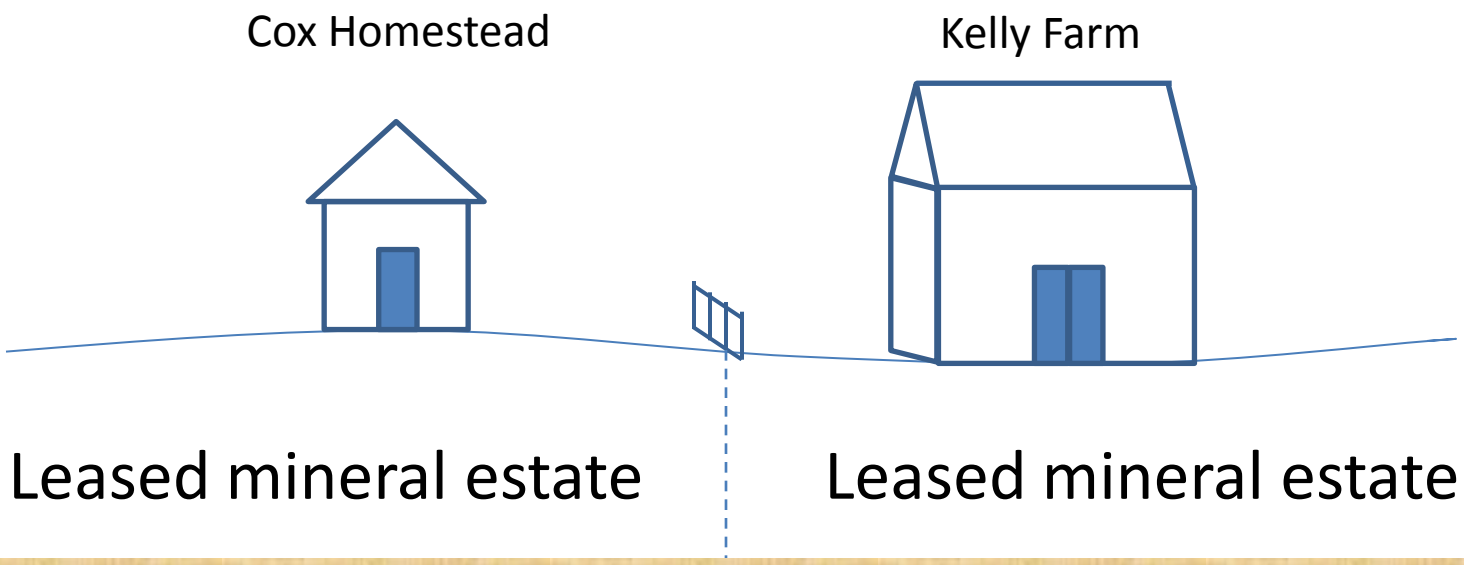
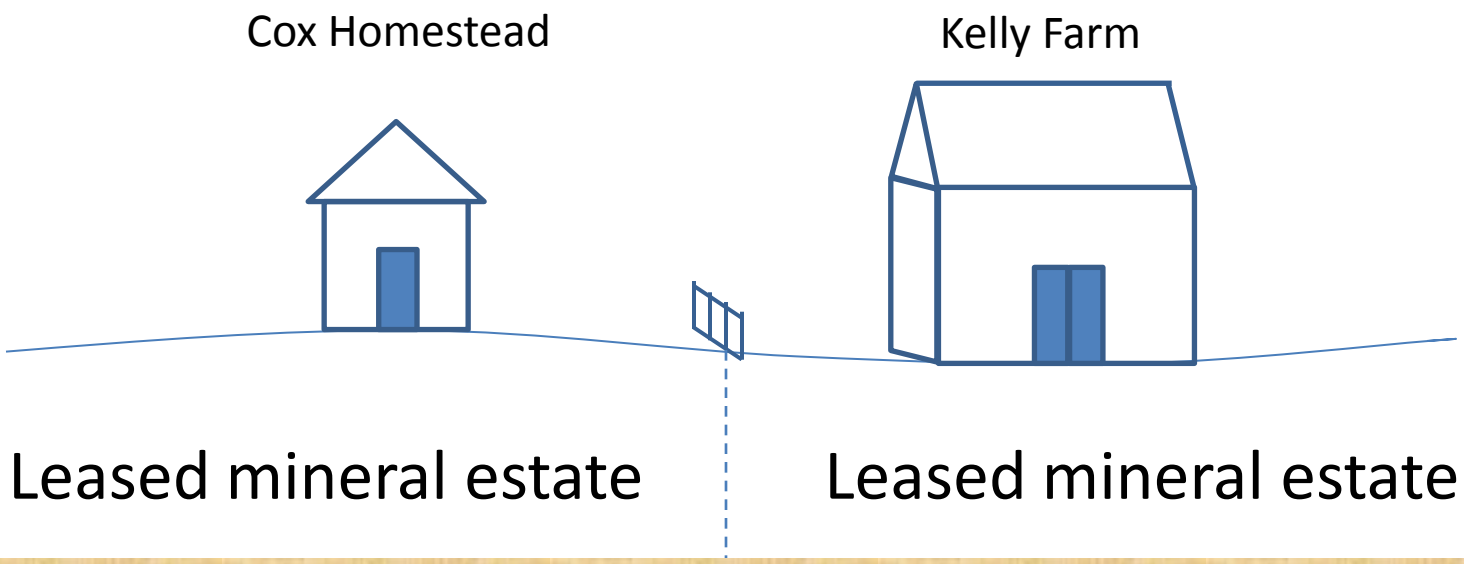


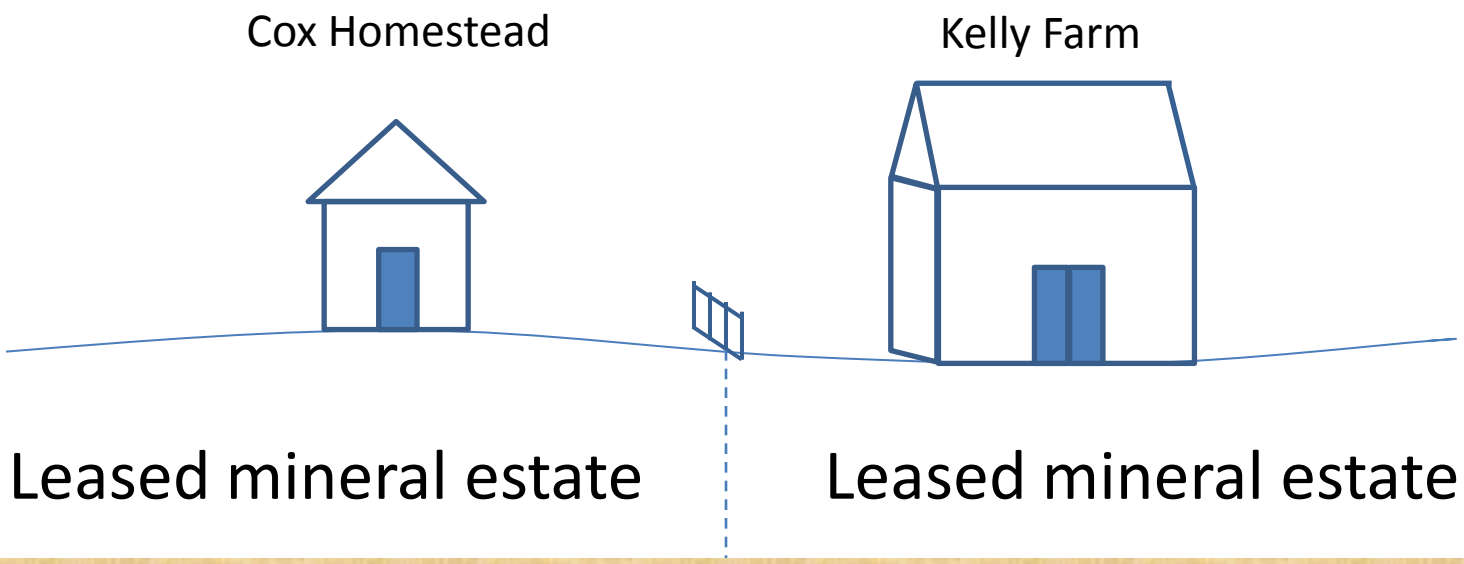
NC law authorizes the State to combine leased estates like the Cox homestead and Kelly farm here into a single drilling unit (G.S. § 113-393) (1945).

Unitization and pooling of leased mineral estates



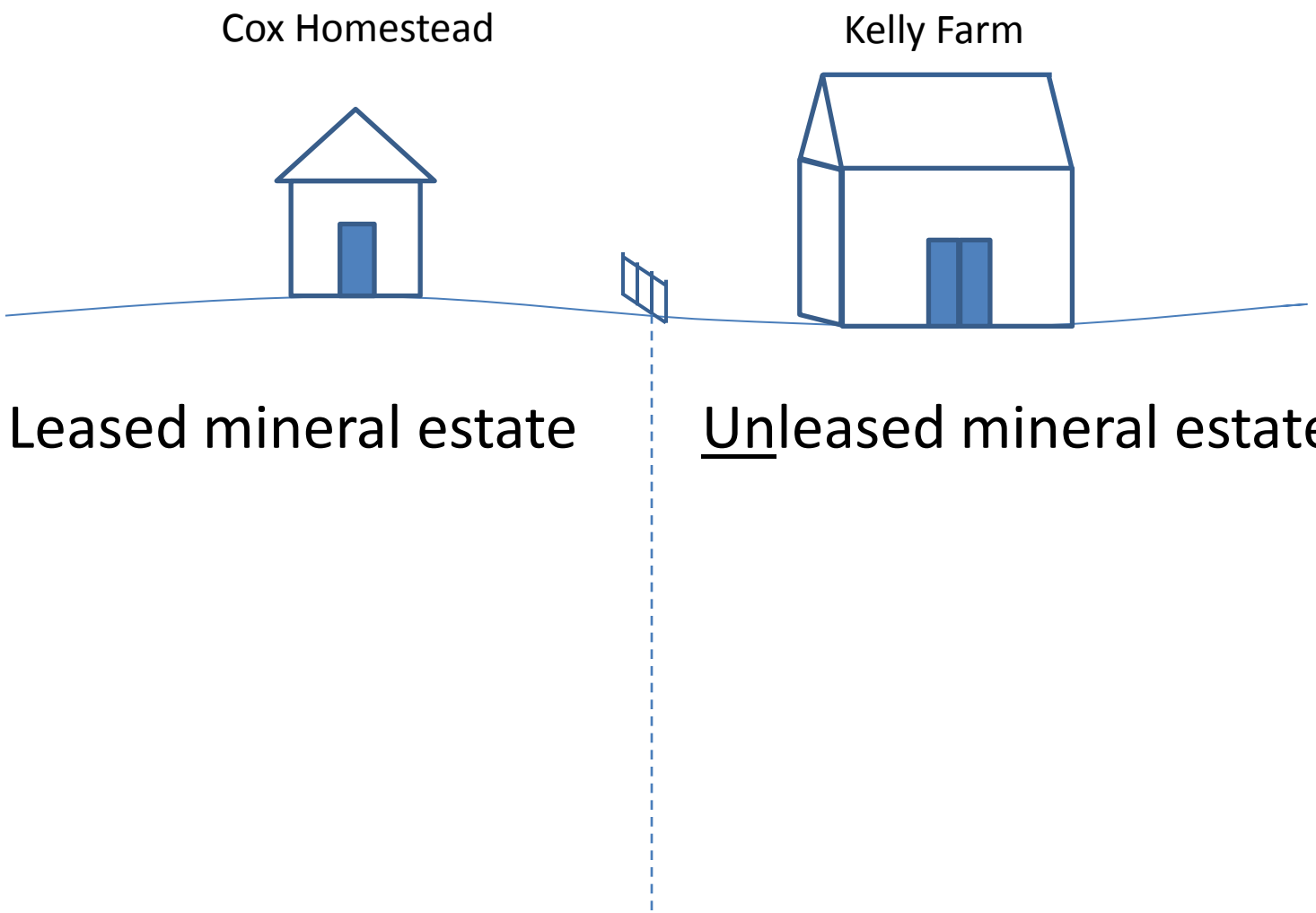
NC law authorizes the State to compel leased mineral estates within a drilling unit into a pool to share production and costs (G.S. § 113-393) (1945).

Unitization and pooling of leased mineral estates



How drilling, production, and reclamation will proceed will be determined by the operator's leases with the Cox family and with the Kelly family, supplemented by State rules.

Unitization and pooling of leased with unleased mineral estates



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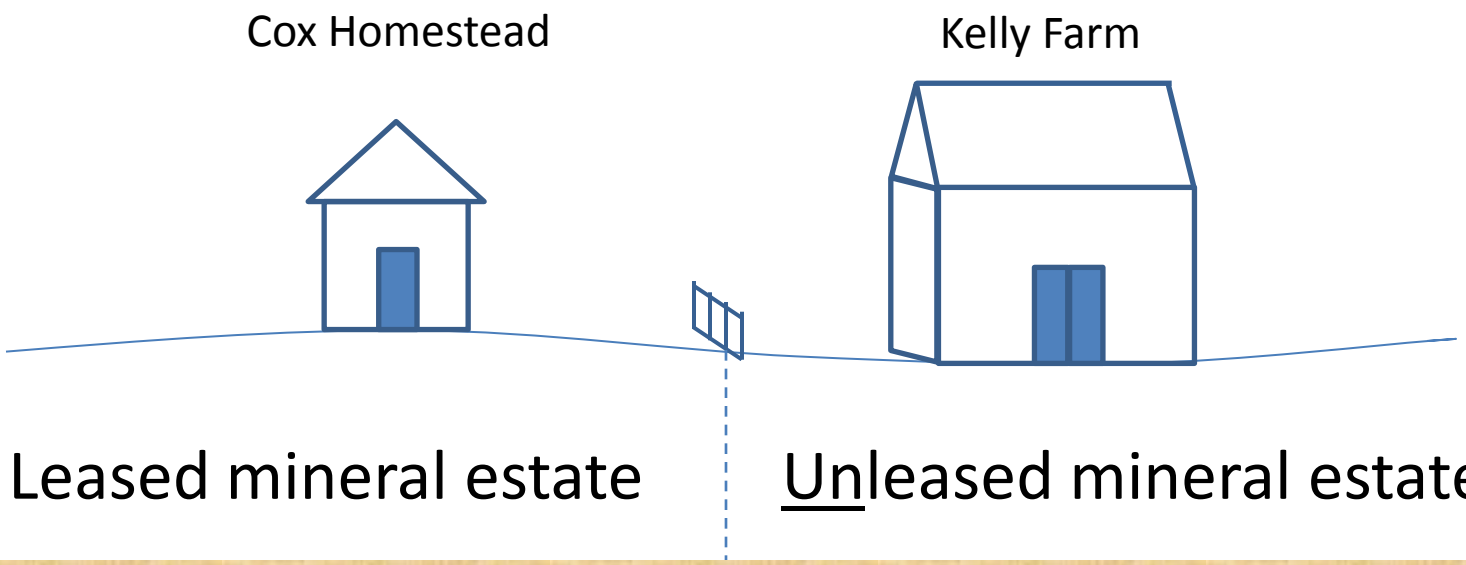
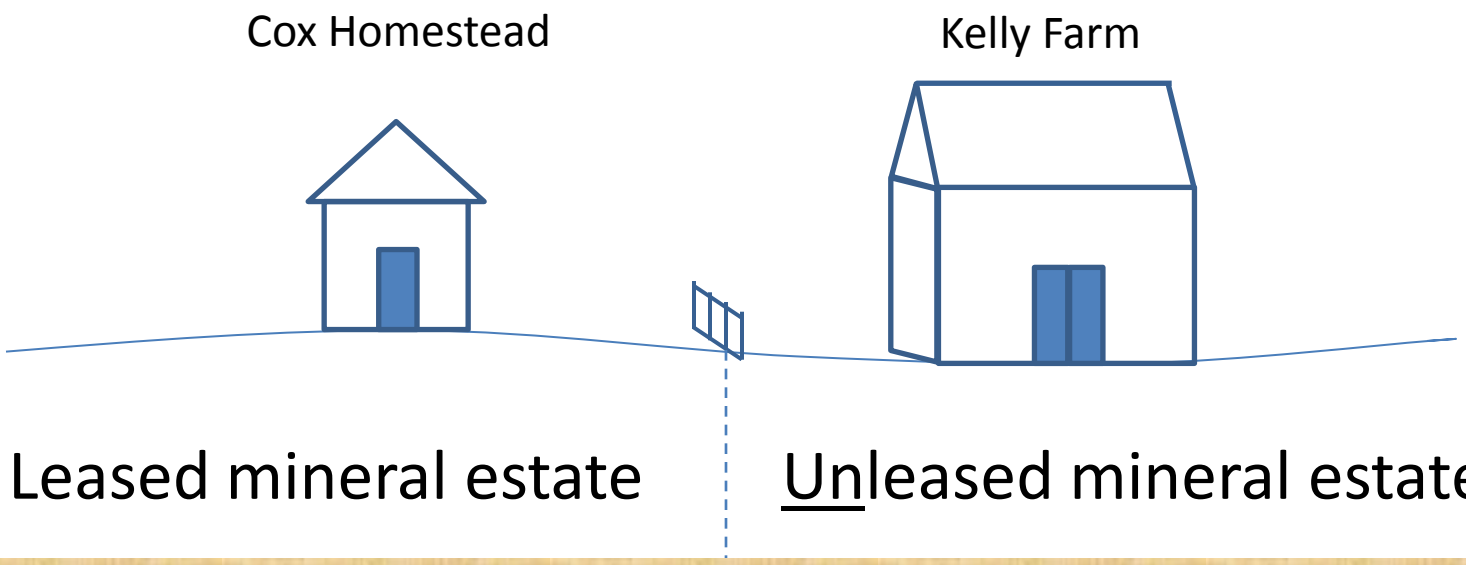


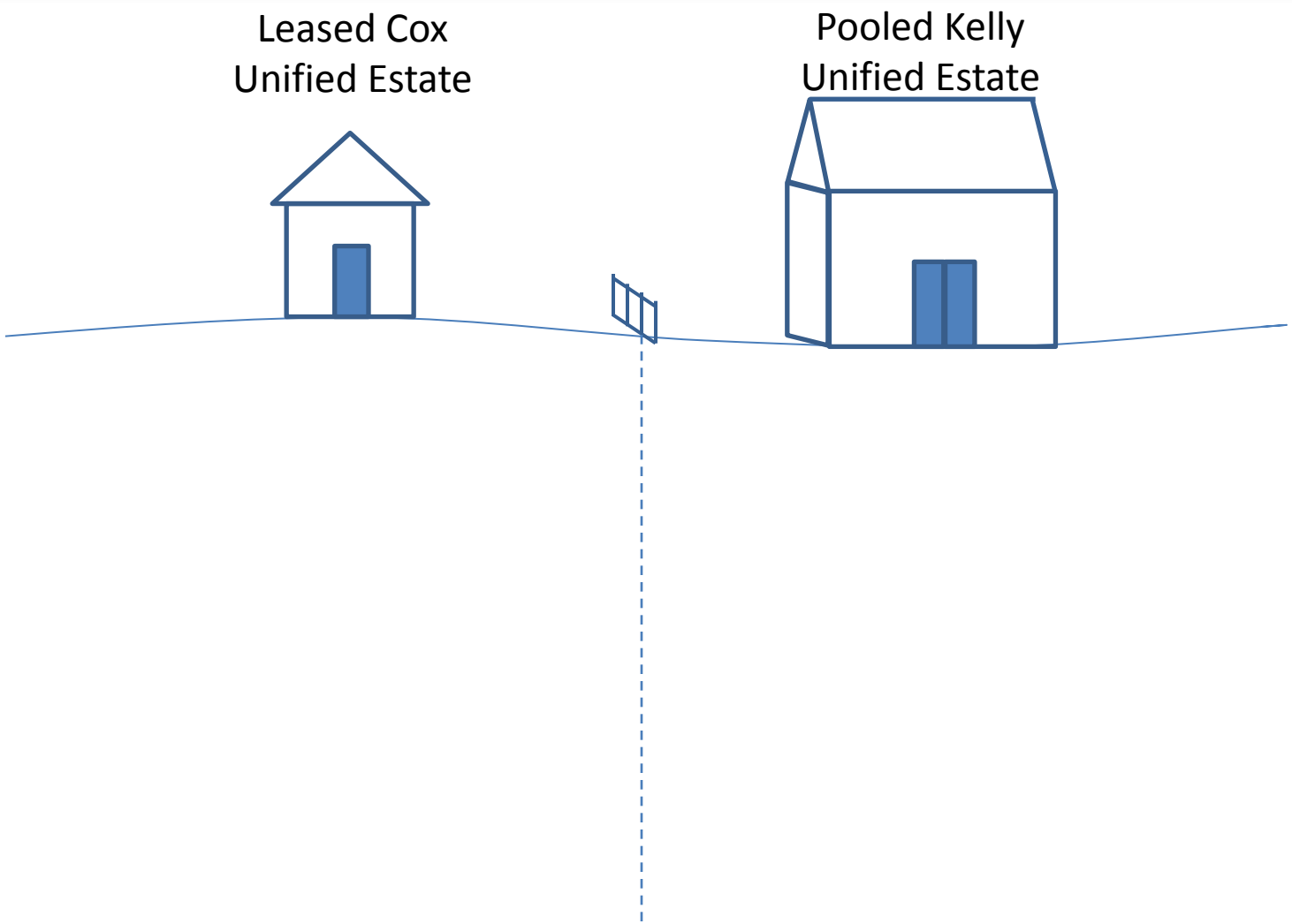
NC law authorizes the State to combine leased estates like the Cox land and unleased estates like the Kelly farm into a single drilling unit (G.S. § 113-393) (1945).

Unitization and pooling of leased with unleased mineral estates



NC law authorizes the State to compel leased mineral estates and unleased mineral estates into a pool to share production and costs (G.S. § 113-393) (1945).

State power to compel granting access easements to gas operators



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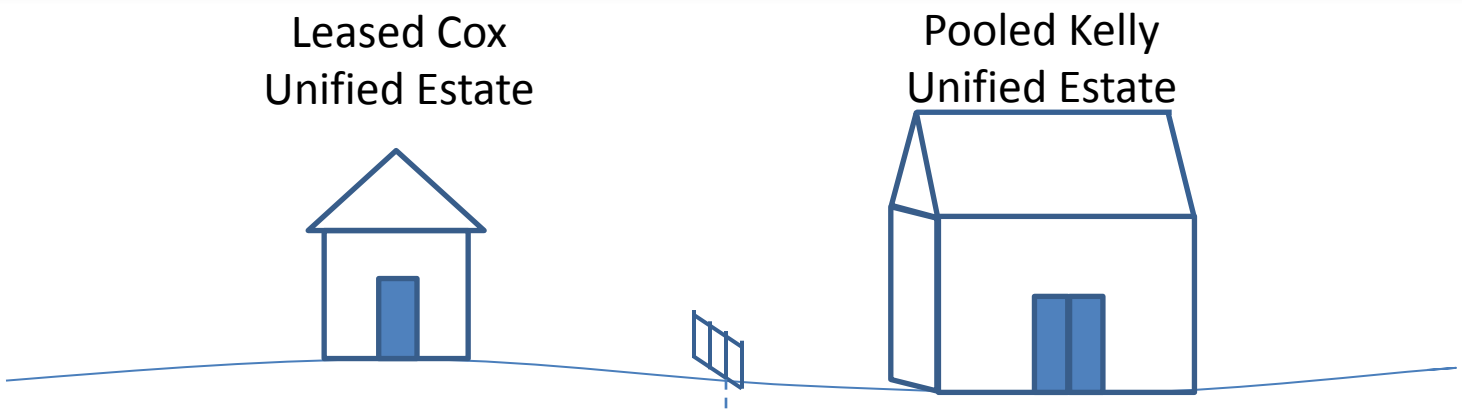
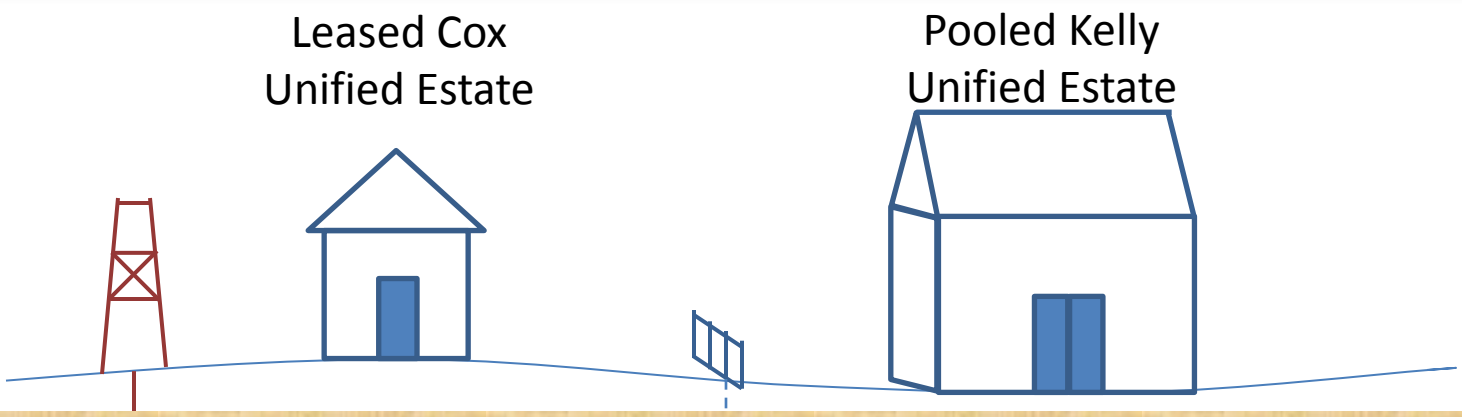
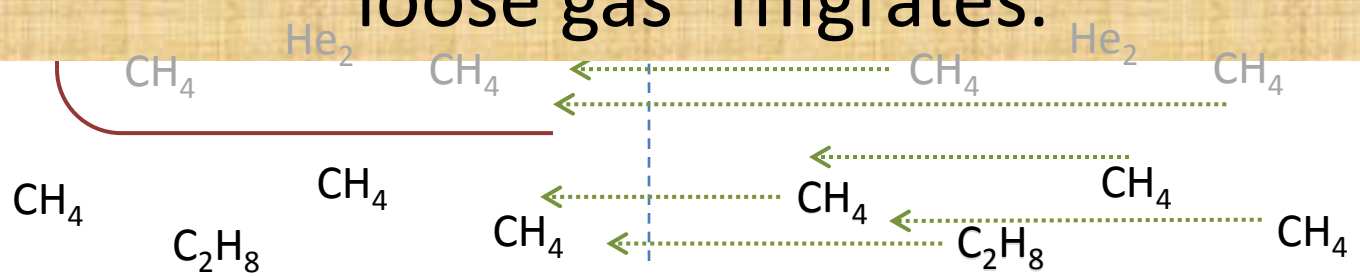


What are the effects on production of the Kellys' gas resource if the State compels pooling?

State power to compel granting access easements to gas operators



In a "loose gas" formation, pooling would enable the Kellys' gas to be produced from the Cox well without surface or subsurface access because "loose gas" migrates.



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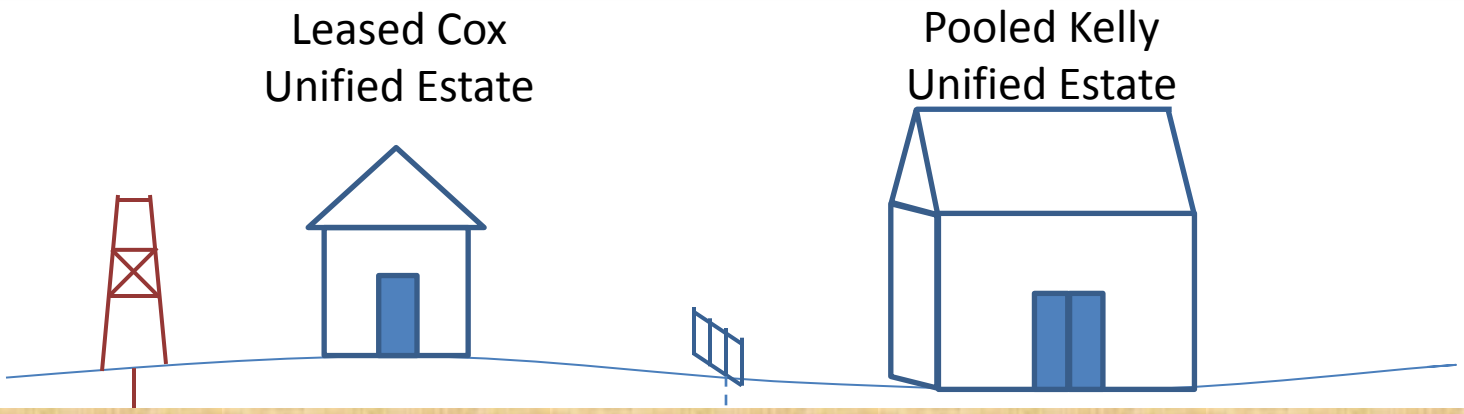
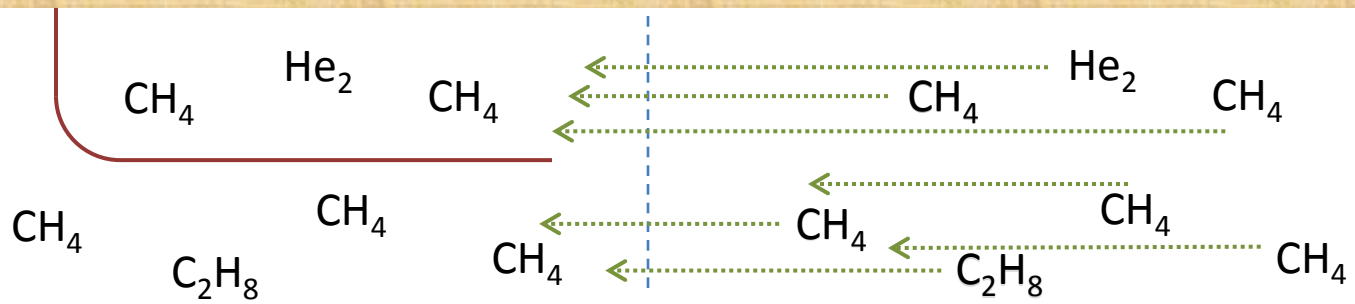


A "loose gas" formation is the circumstance that the 1945 NC Oil & Gas Conservation Act contemplated.



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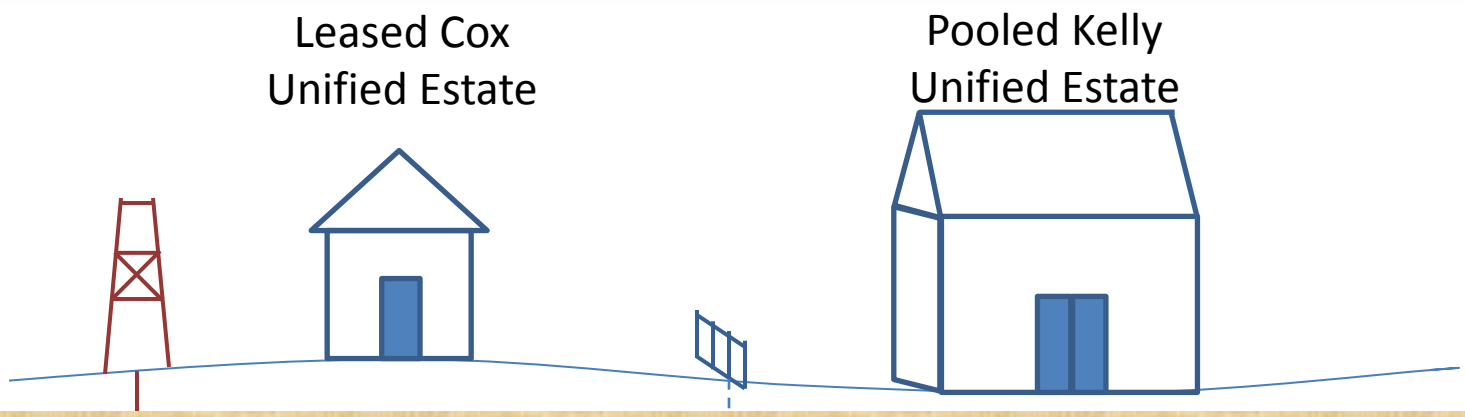
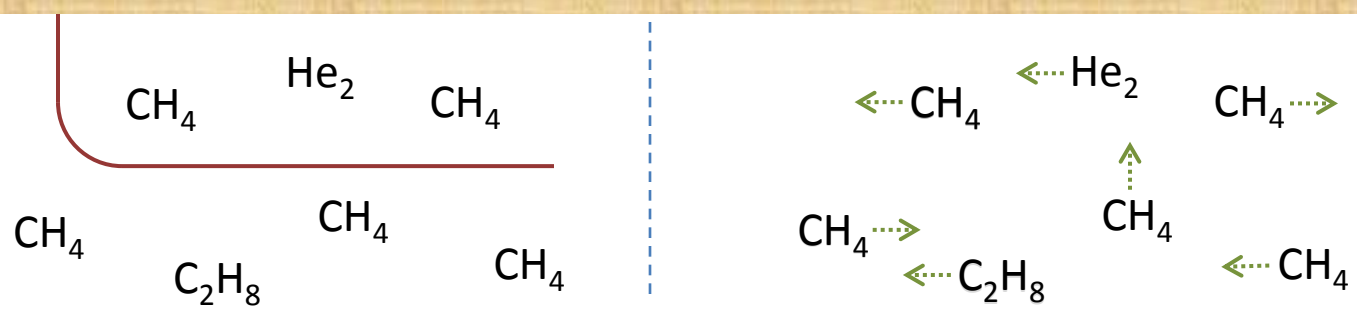


But NC's Triassic Basin is a "tight gas" formation. Gas, locked in the shale, is unlikely to migrate to a nearby well in significant quantities, if at all.



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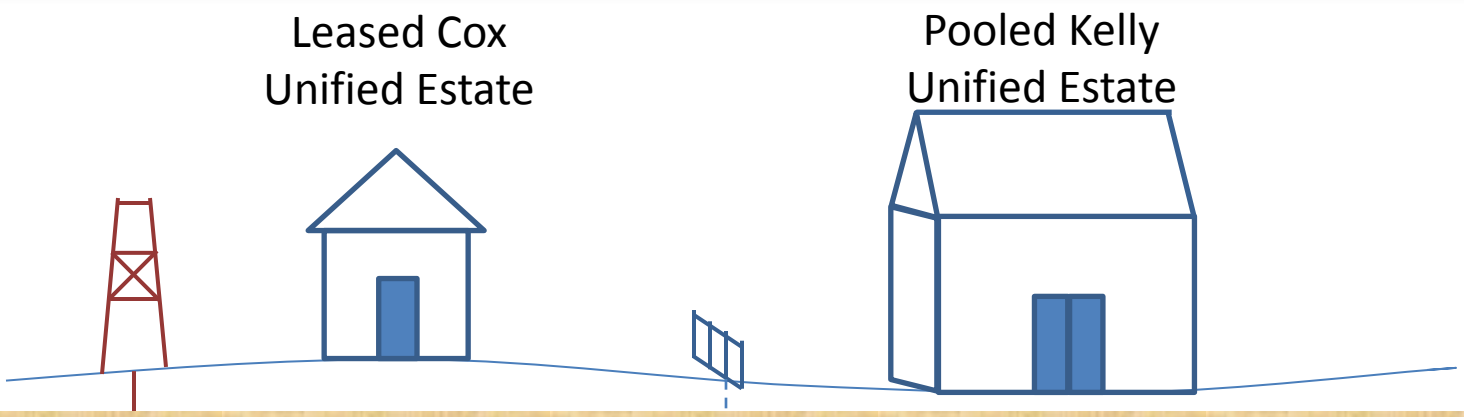
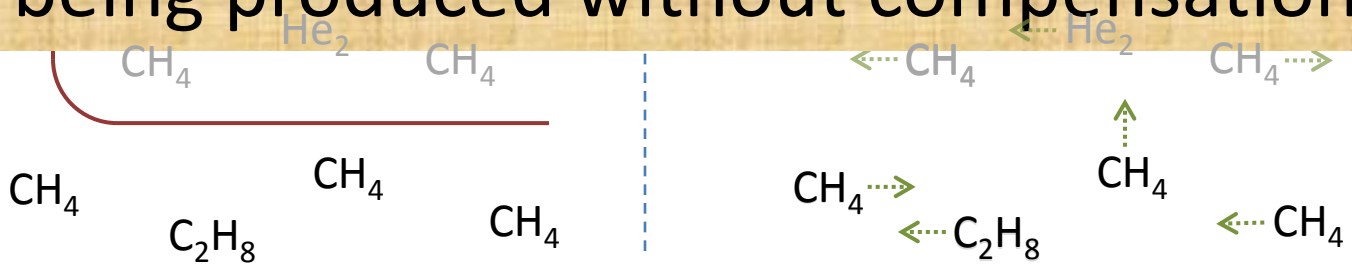


"Tight gas" formations undercut the primary consumer protection basis for pooling – preventing gas in an adjacent estate from being produced without compensation.



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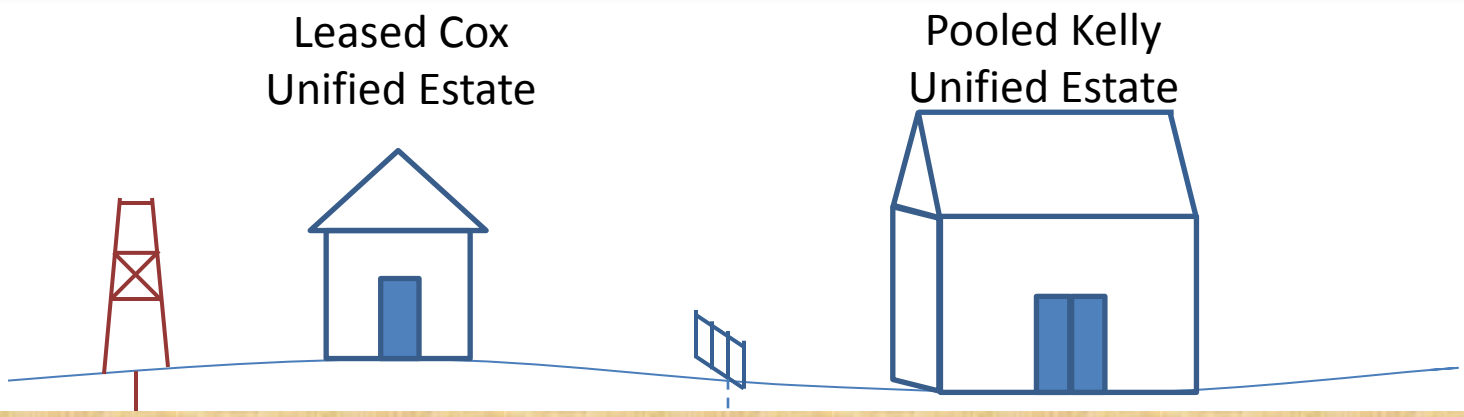
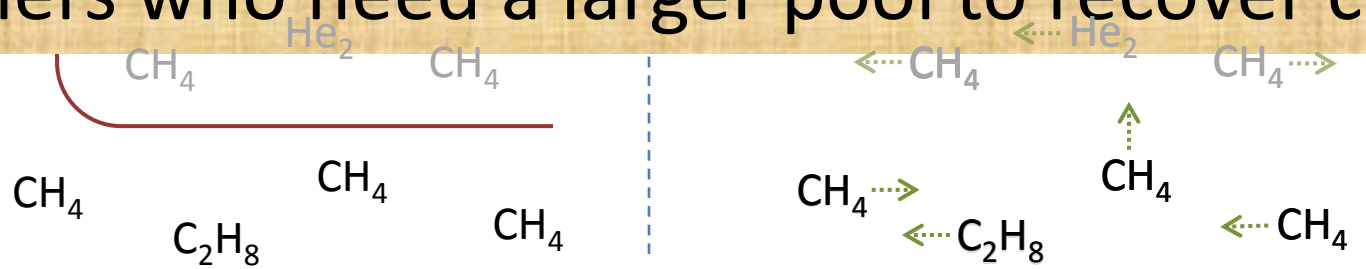


However, the inability of tight gas to migrate strengthens the economic rationale for pooling for operators and "orphaned" mineral rights owners who need a larger pool to recover costs.



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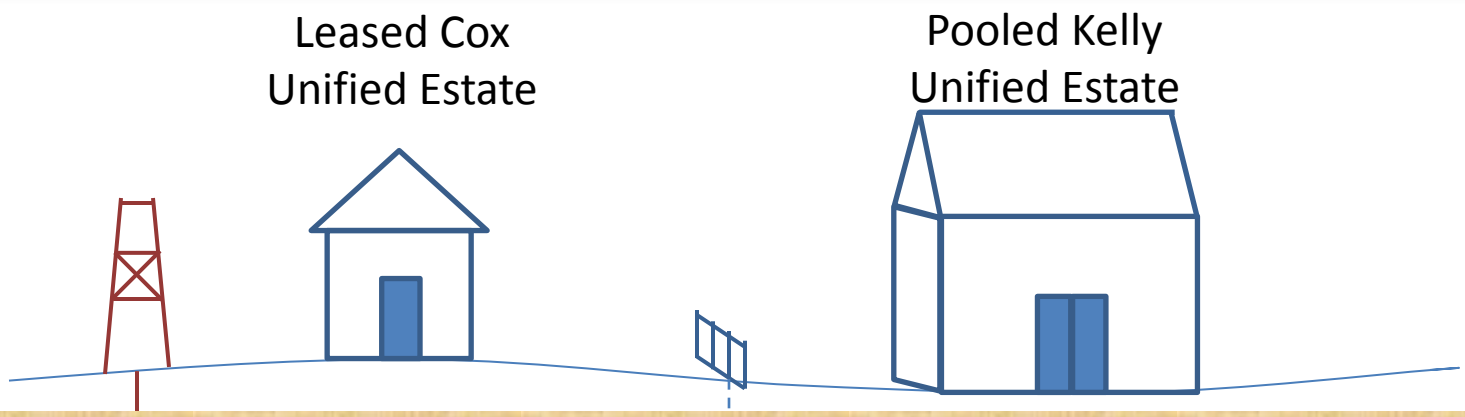
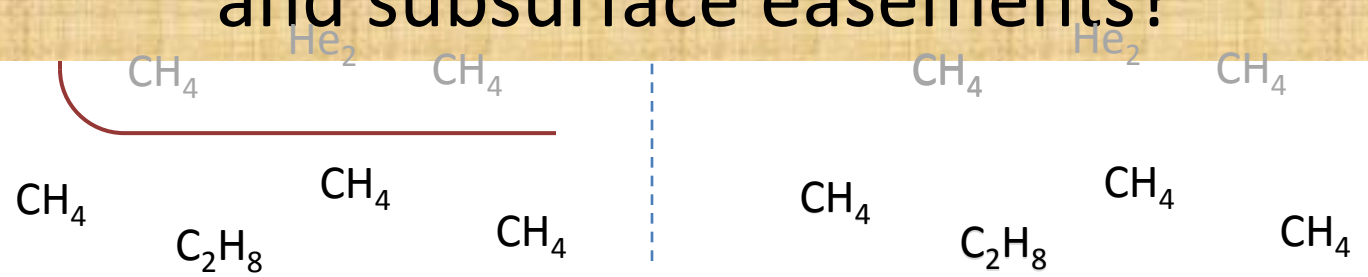


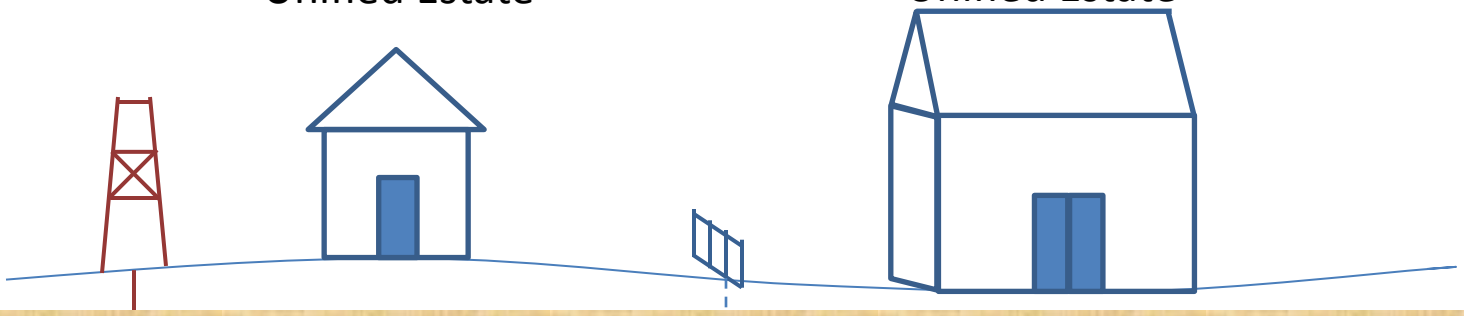
Which raises the question, if the State pools an unleased property like the Kelly farm, can the State also compel the Kellys to grant surface and subsurface easements?



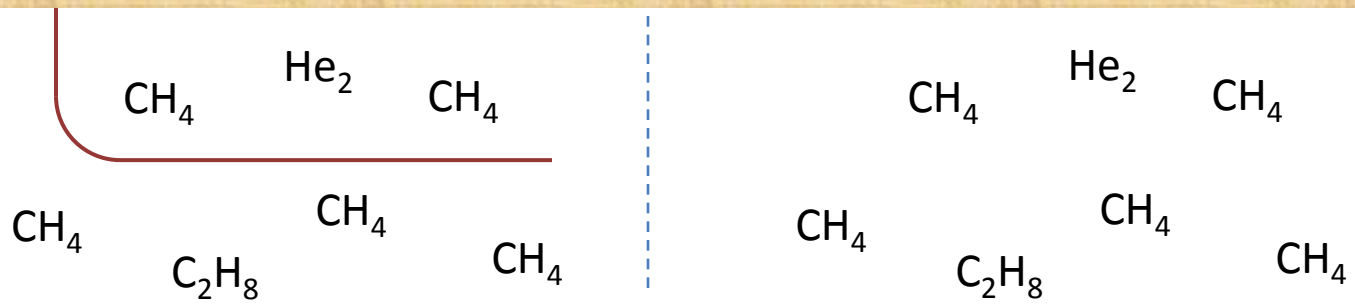
State power to compel granting access easements to gas operators

Leased Cox
Unified Estate

Pooled Kelly
Unified Estate



Put differently, after the Kelly property is pooled, what rights will the gas operator have on and under the Kelly family farm?



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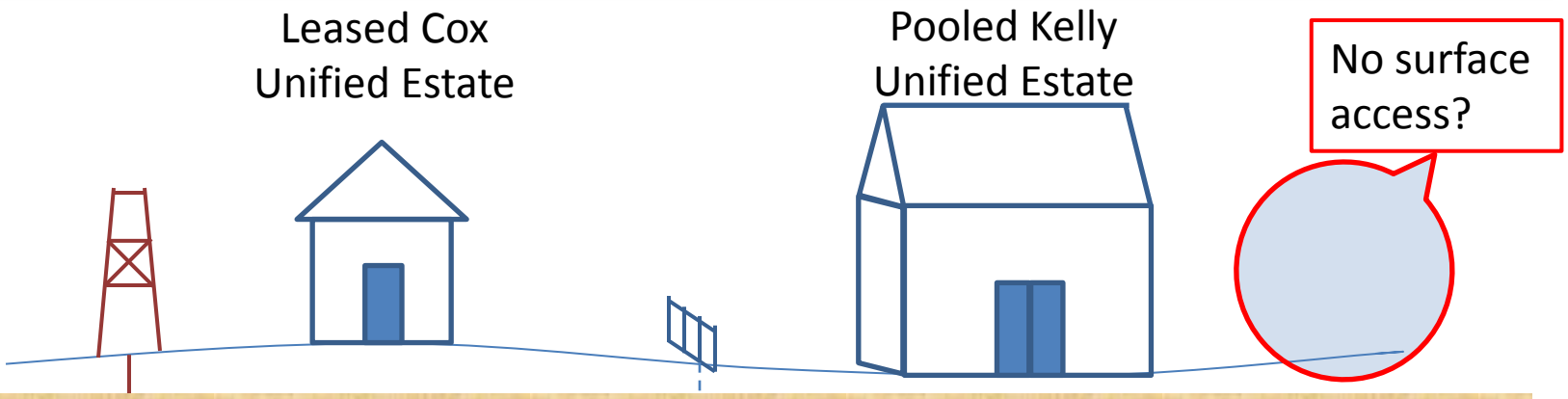
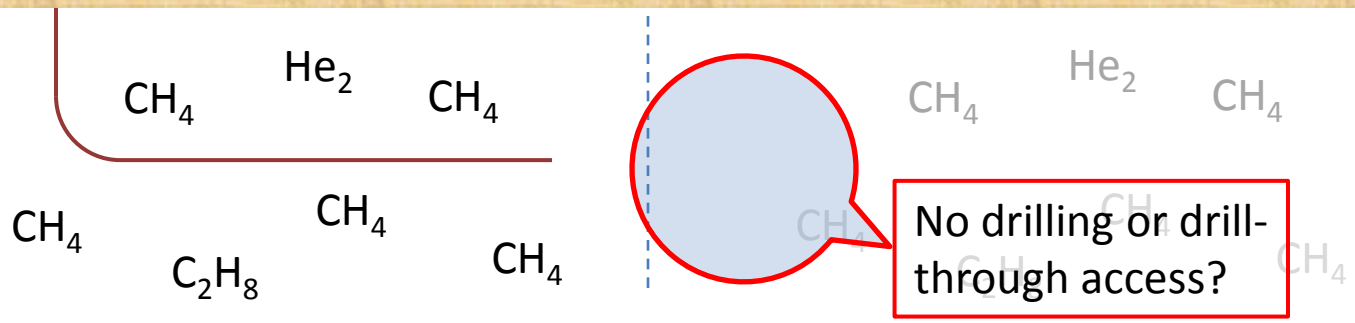


Will the State's authority be limited to compelling the Kelly family into a pool with the Cox family?



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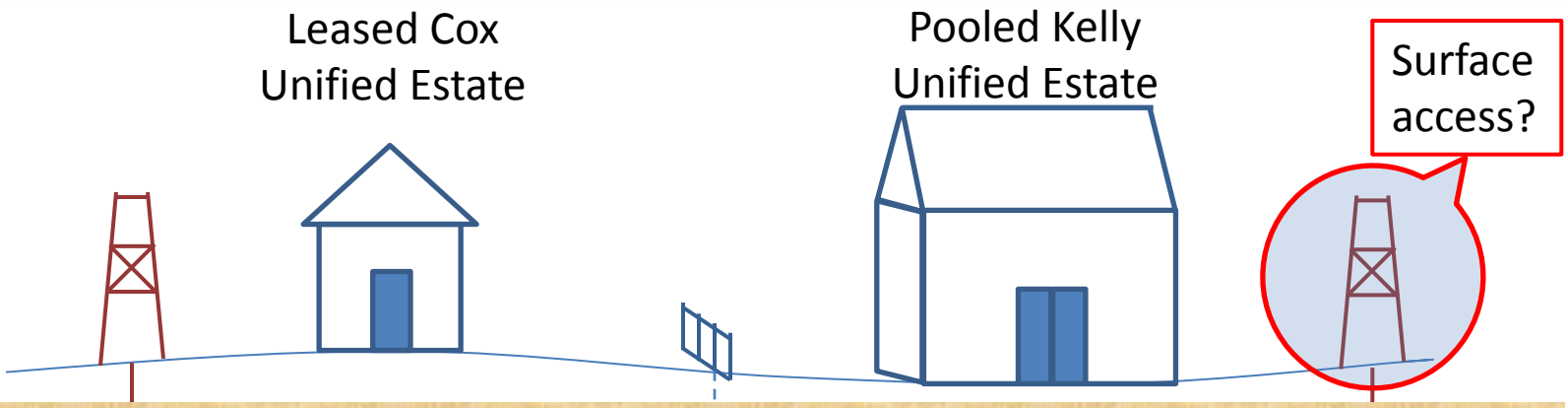
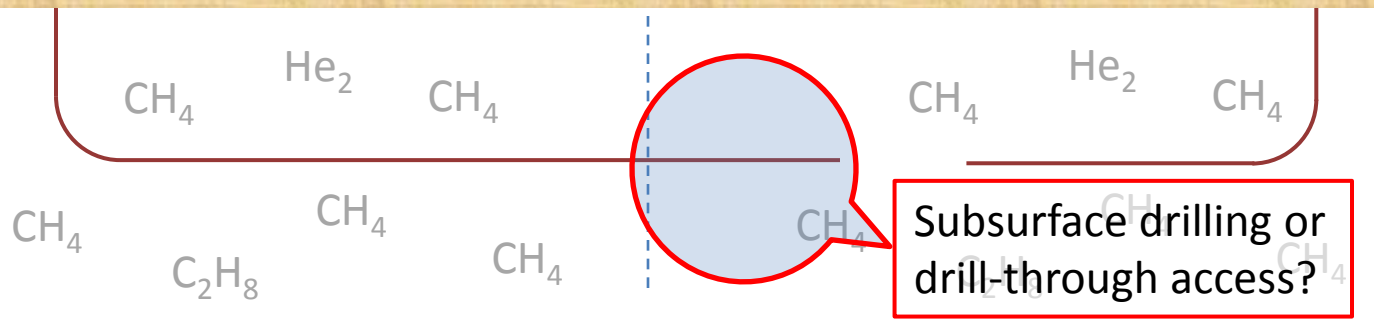


Or will the State have the authority to compel the Kellys to grant the operator access to the surface and subsurface of the Kelly property?



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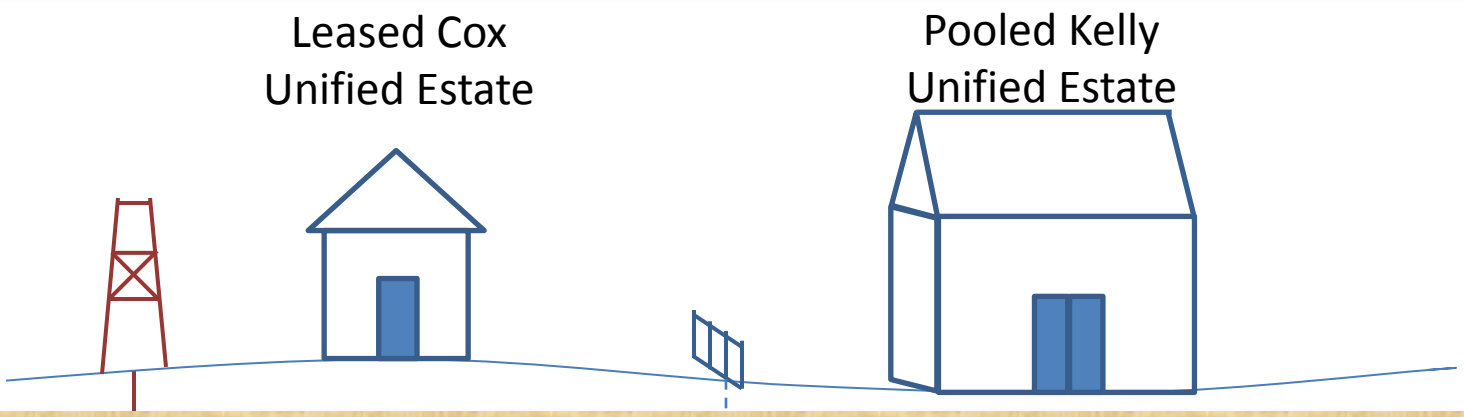
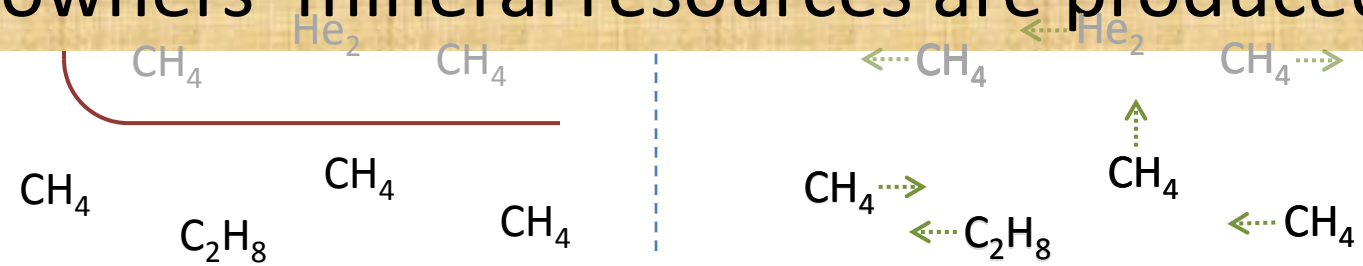


Whether or not operators are granted surface and subsurface access rights significantly affects estate owners beyond whether estate owners' mineral resources are produced.



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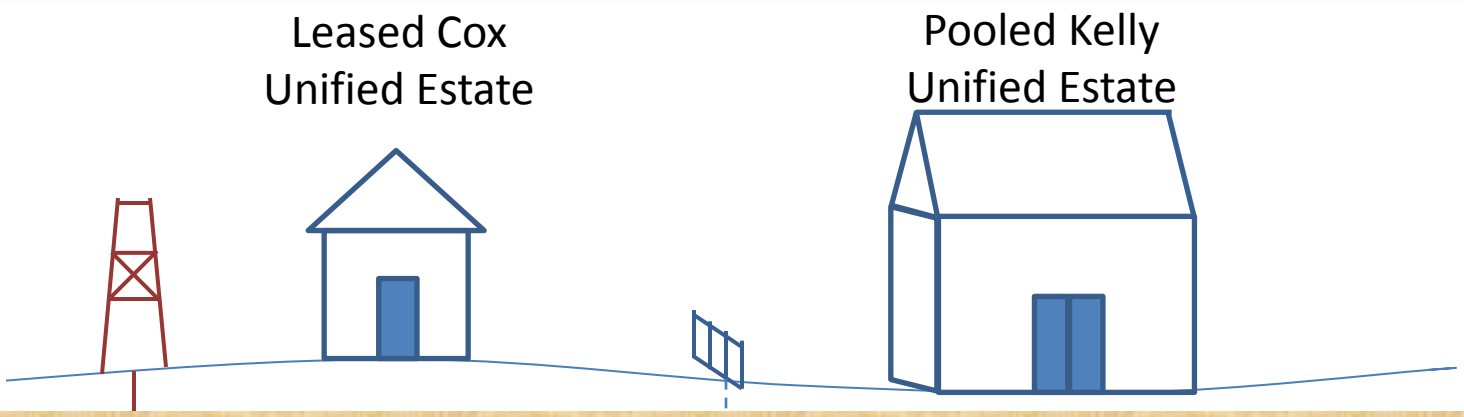
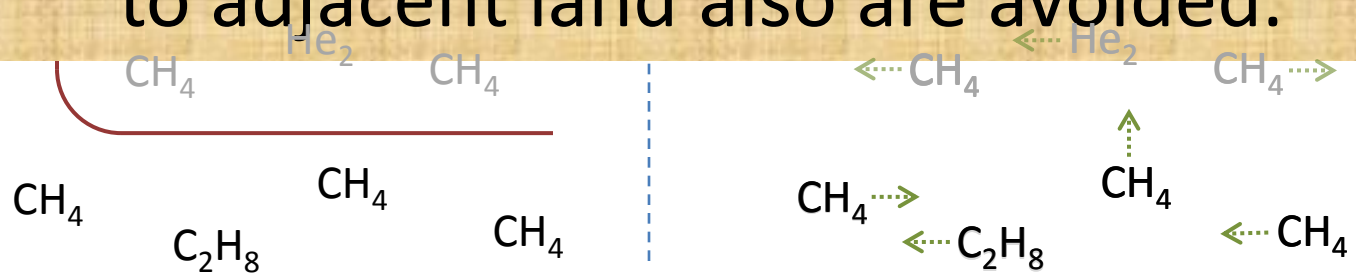
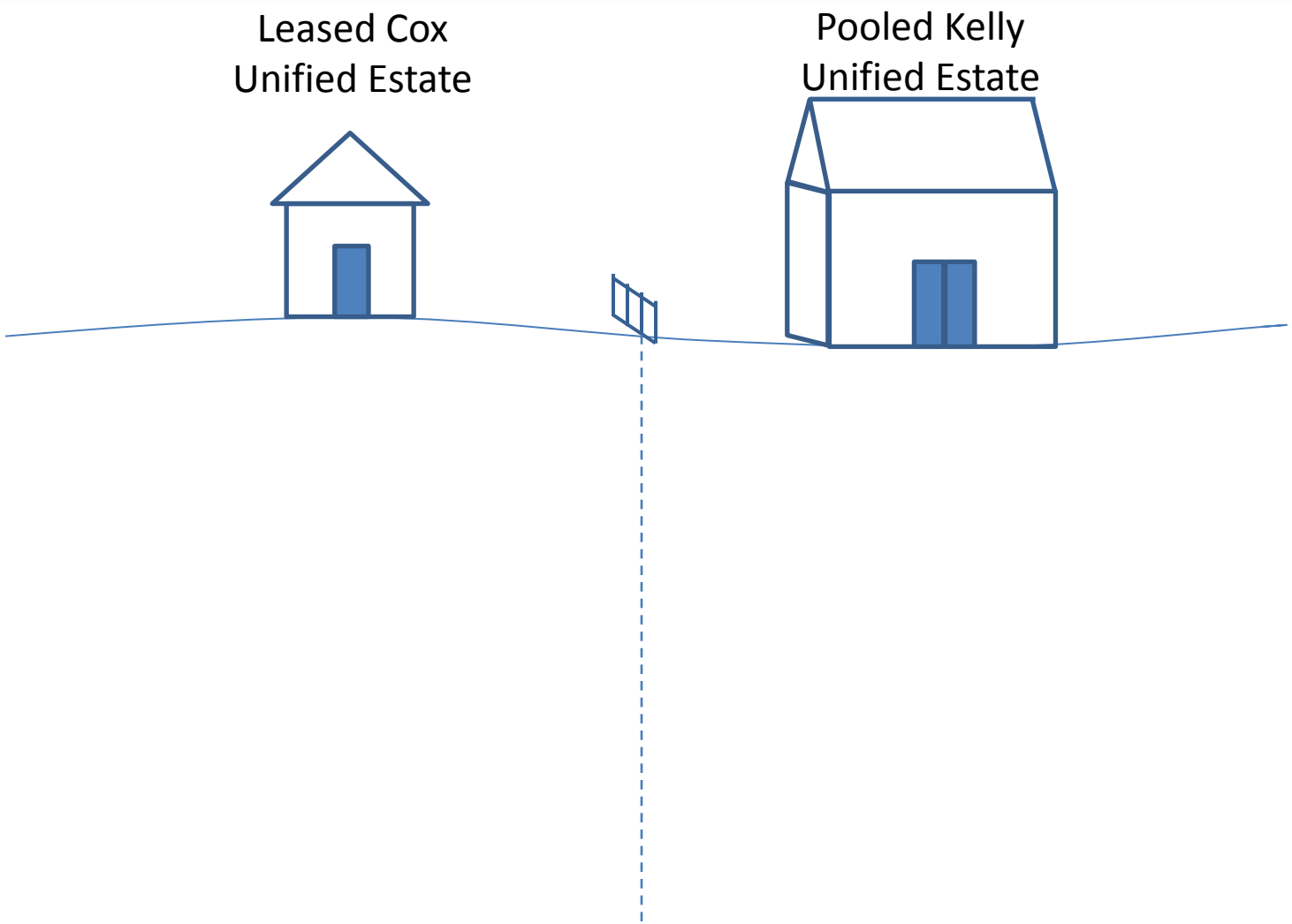


Without surface and subsurface easements, "tight gas" cannot be produced via wells on adjacent properties, but many other impacts to adjacent land also are avoided.



Rules governing development and production of pools



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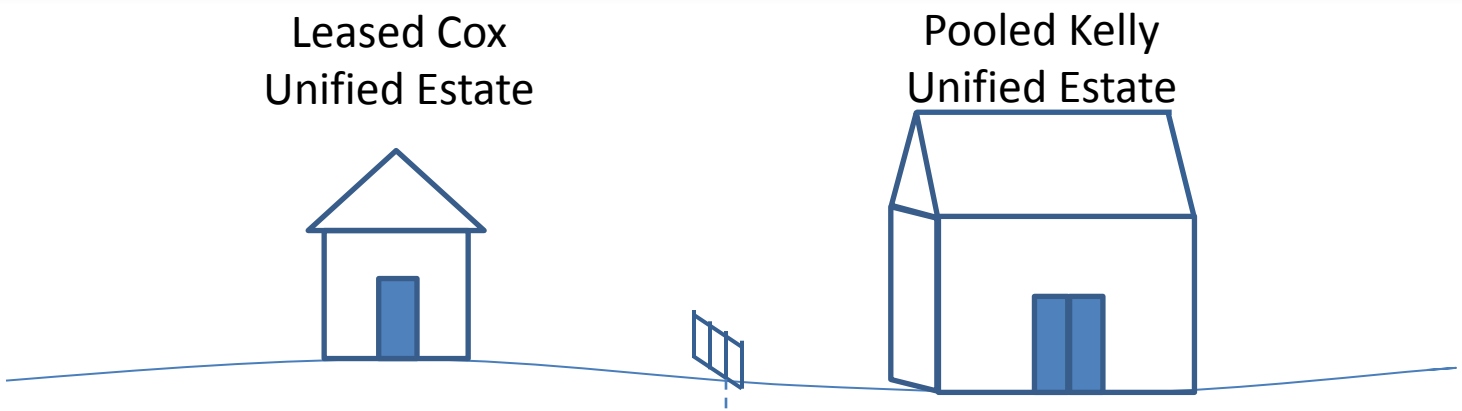
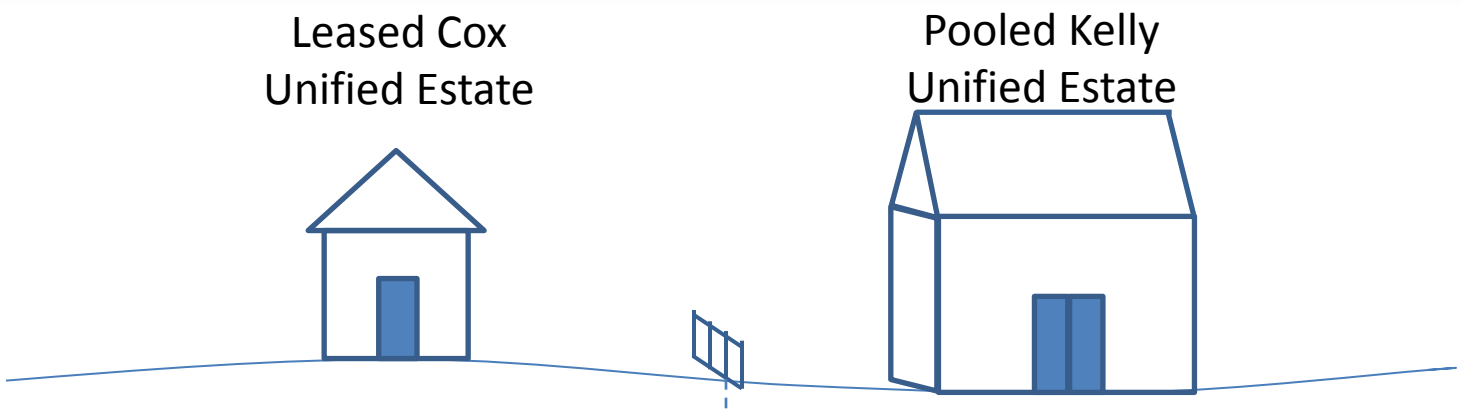


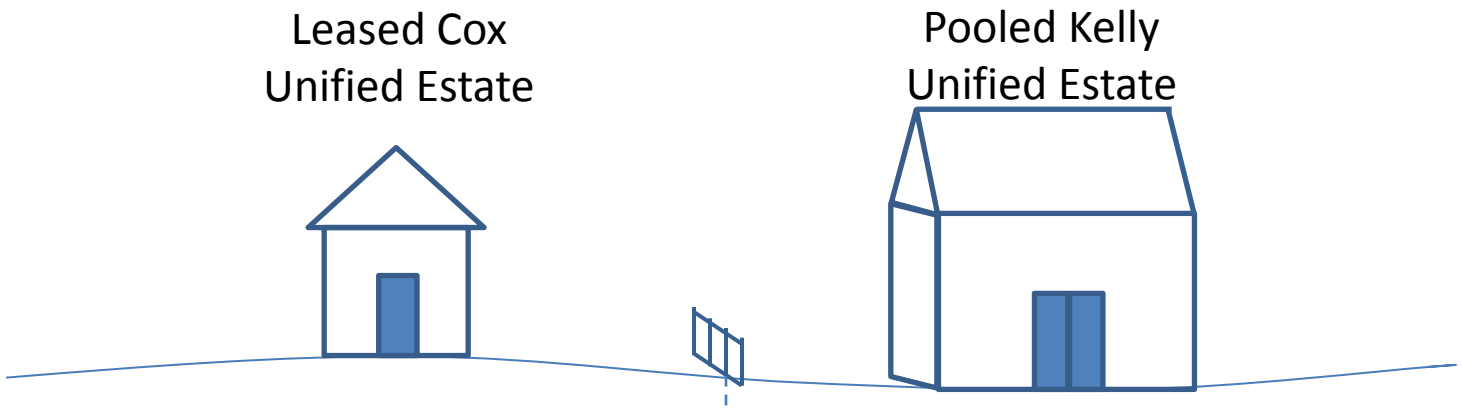
Another significant issue affecting landowners is which rules govern drilling, production, and reclamation on pooled properties.

Rules governing development and production of pools



In an example like the one above where the Cox family has a lease and the Kelly family does not, what rules govern how drilling, production, and reclamation will proceed on the pooled Cox and Kelly family properties?

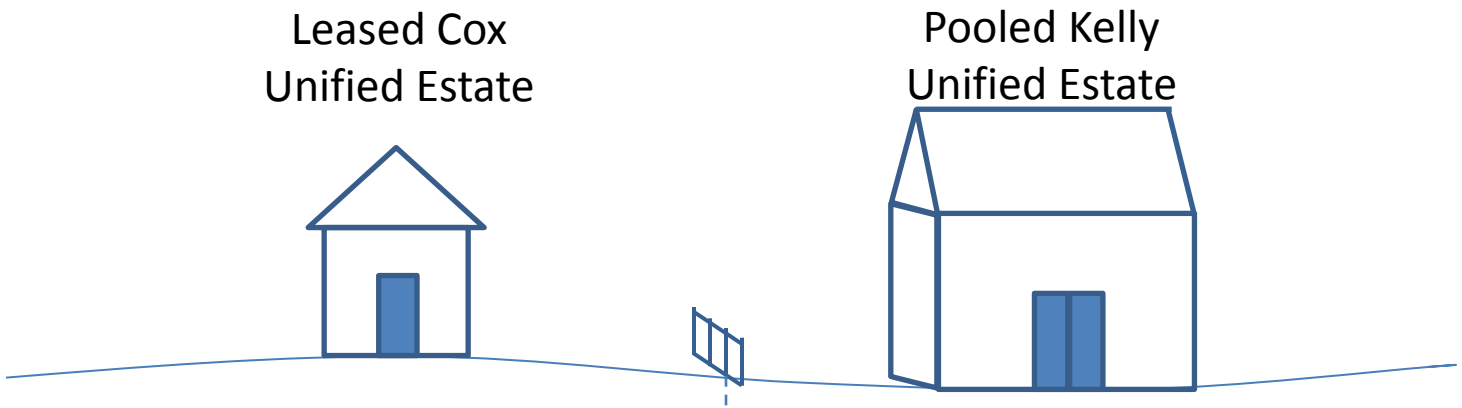
Rules governing development and production of pools



In this example, what rules govern how drilling, production, and reclamation will proceed on the pooled Cox and Kelly family properties?

Cox Estate: Lease and State rules

Rules governing development and production of pools

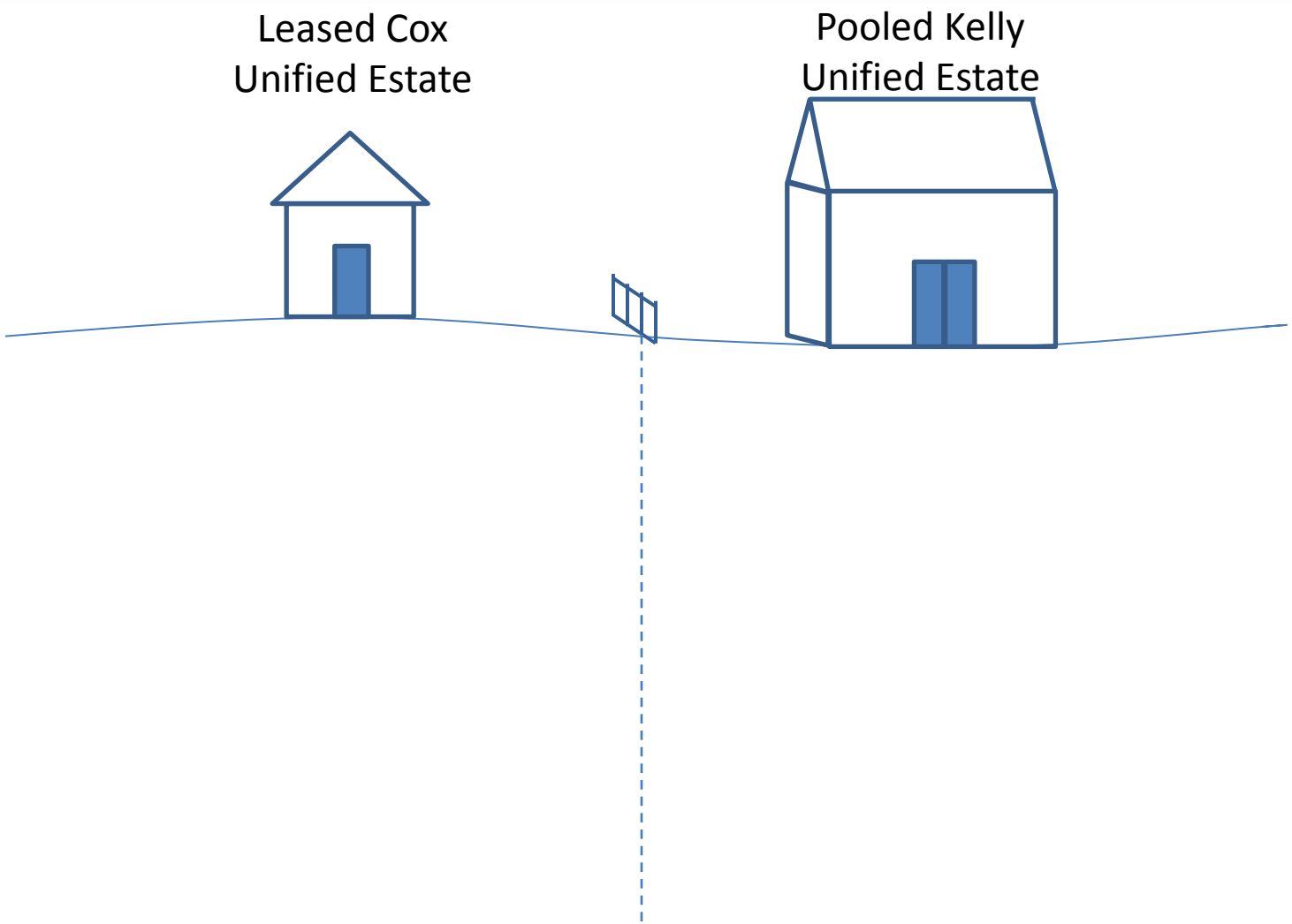


In this example, what rules govern how drilling, production, and reclamation will proceed on the pooled Cox and Kelly family properties?

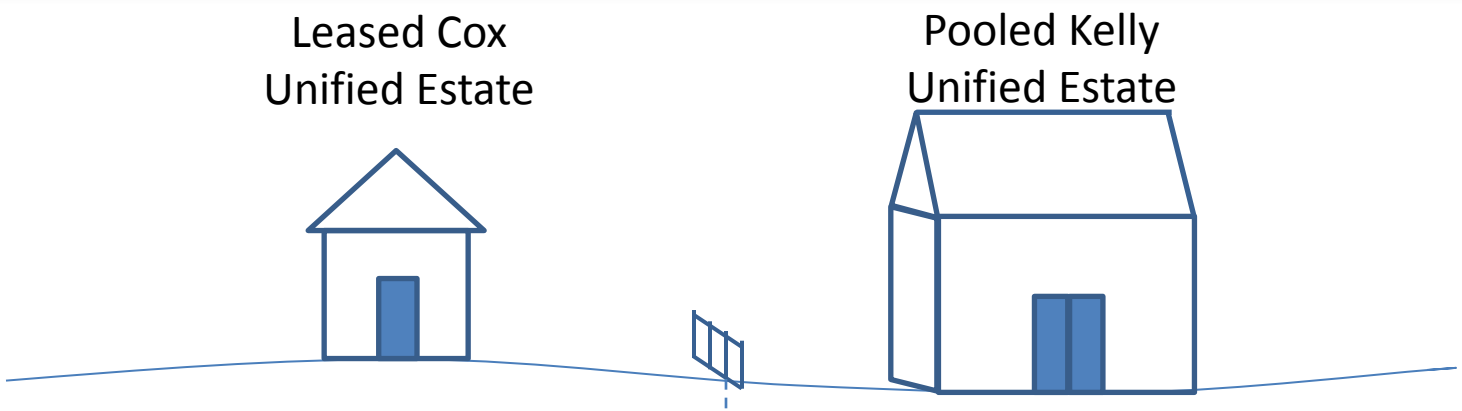
Cox Estate: Lease and State rules

Kelly Estate: State rules only

How easements and governing rules affect landowners

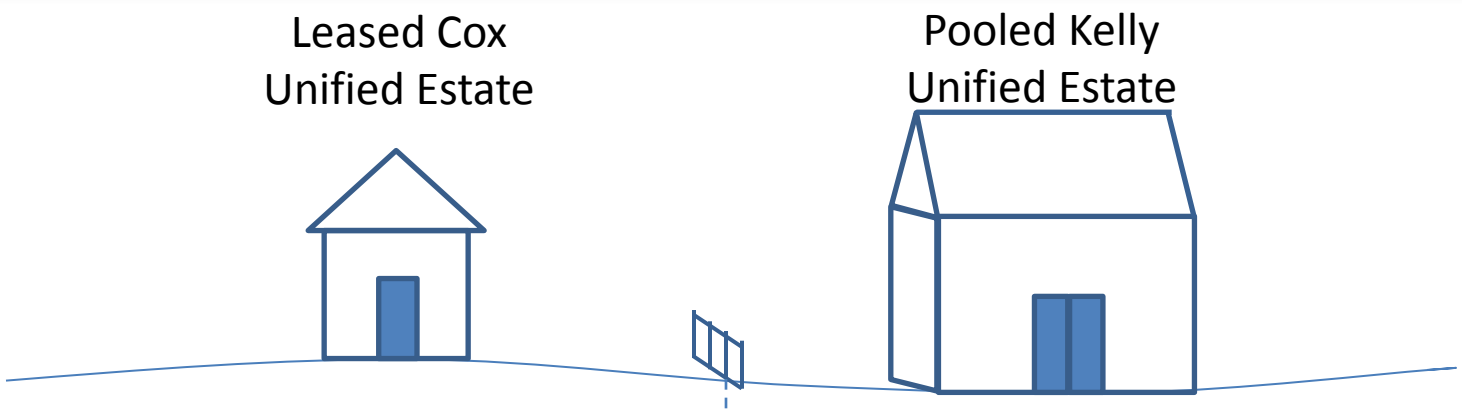


How easements and governing rules affect landowners



How surface and subsurface easements and how the source of rules governing gas operations will affect landowners can be seen by considering the lifecycle of a lease on the pooled Cox and Kelly family properties.

How easements and governing rules affect landowners



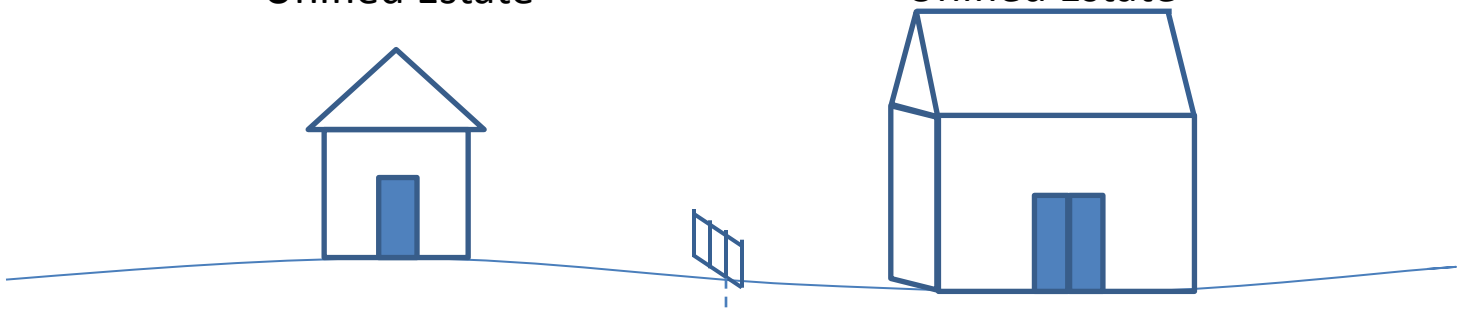
Scene 1

After the pooling order is completed, a truck arrives with a crew ready to begin surveying and conducting seismic tests.

How easements and governing rules affect landowners

Leased Cox
Unified Estate

Pooled Kelly
Unified Estate



1. Operator survey and seismic test

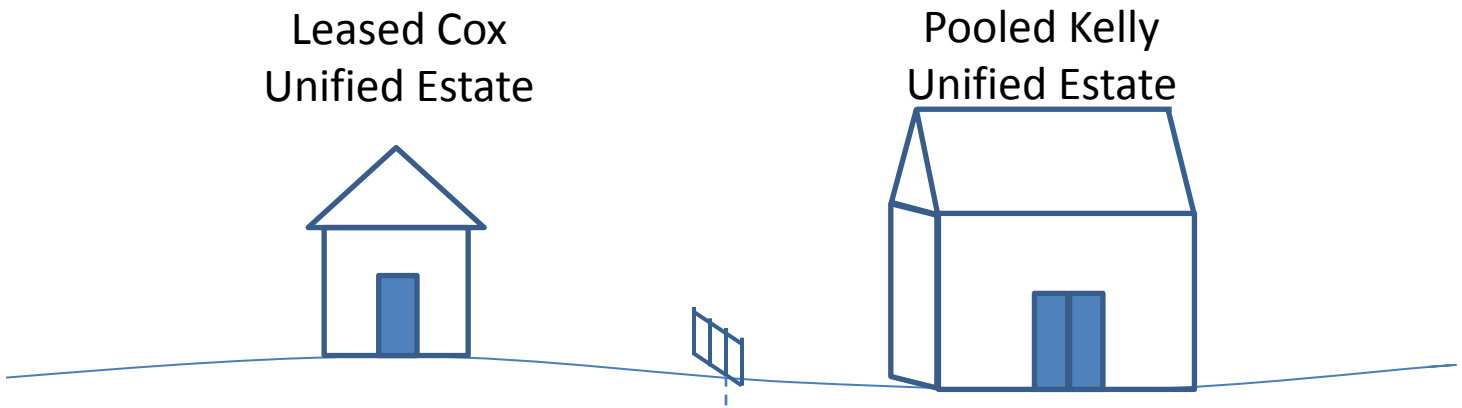
Cox Lease

- **Notice:** Notice prior to testing to enable landowner to secure fenced or gated areas or move equipment or activities
- **Testing Limits:** Types, timing, and manner of testing limited

Current State rules

- No notice
- No limitations on testing

Rules governing development and production of pools



1. Operator survey and seismic test (cont.)

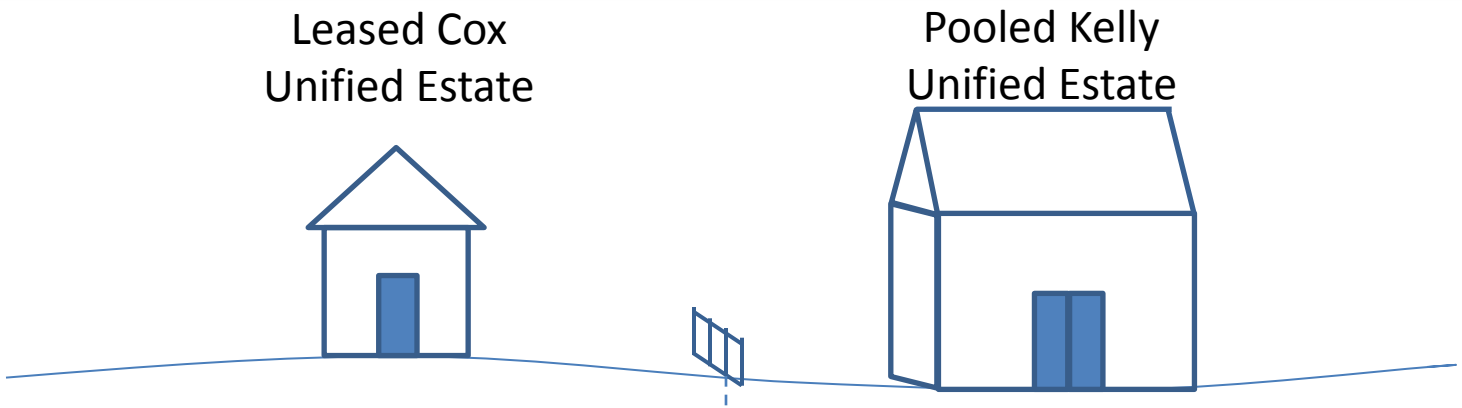
Cox Lease

- **Vegetation:** Minimize vegetation impacts, prior written approval to destroy vegetation, pay fair market value for damages, set valuation method

Current State rules

- No limitations on vegetation impacts, damages negotiated after fact or determined in court

Rules governing development and production of pools



1. Operator survey and seismic test (cont.)

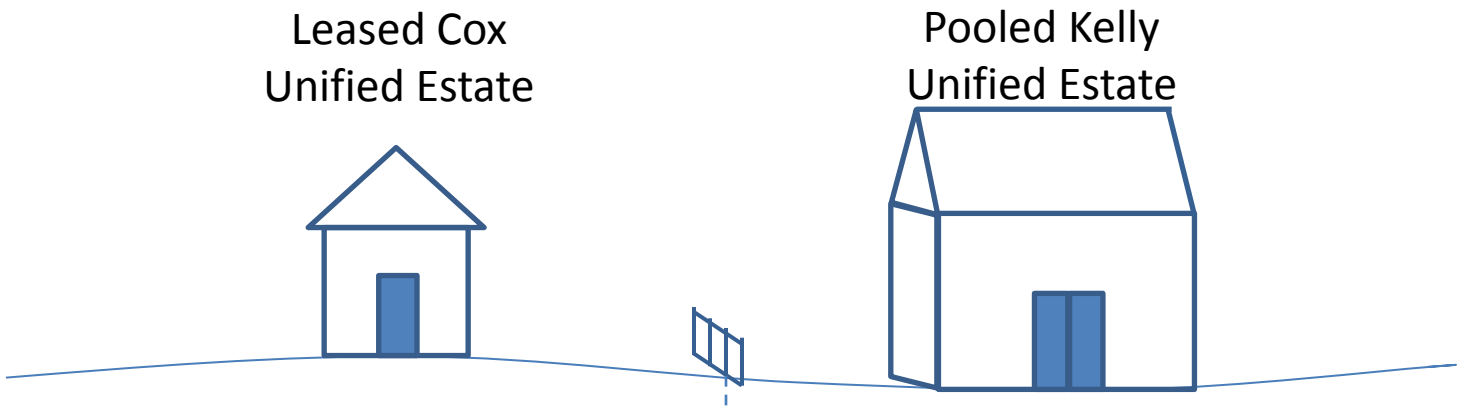
Cox Lease

- **Structures:** No impacts (gates, fences, buildings) without prior written approval & agreement on compensation
- **Roads:** Use existing access roads except by written approval, remediate grass and turf

Current State rules

- Damages to structures negotiated after fact or determined in court
- No limits on off-road access, damages negotiated after fact or determined in court

Rules governing development and production of pools



1. Operator survey and seismic test (cont.)

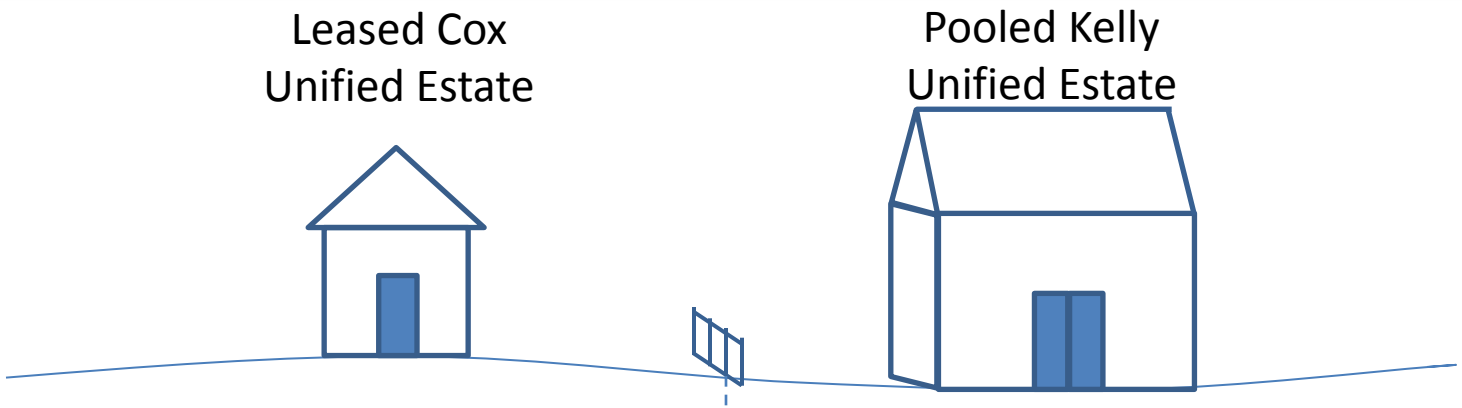
Cox Lease

- **Holes** drilled to be smallest bore possible, plugged & remediated
- Minimum **buffer** established for testing activities from structures, water sources, underground pipes, livestock

Current State rules

- Note limits on bore holes or remediation mandated
- No buffer between testing and existing infrastructure, water sources, or livestock

Rules governing development and production of pools



1. Operator survey and seismic test (cont.)

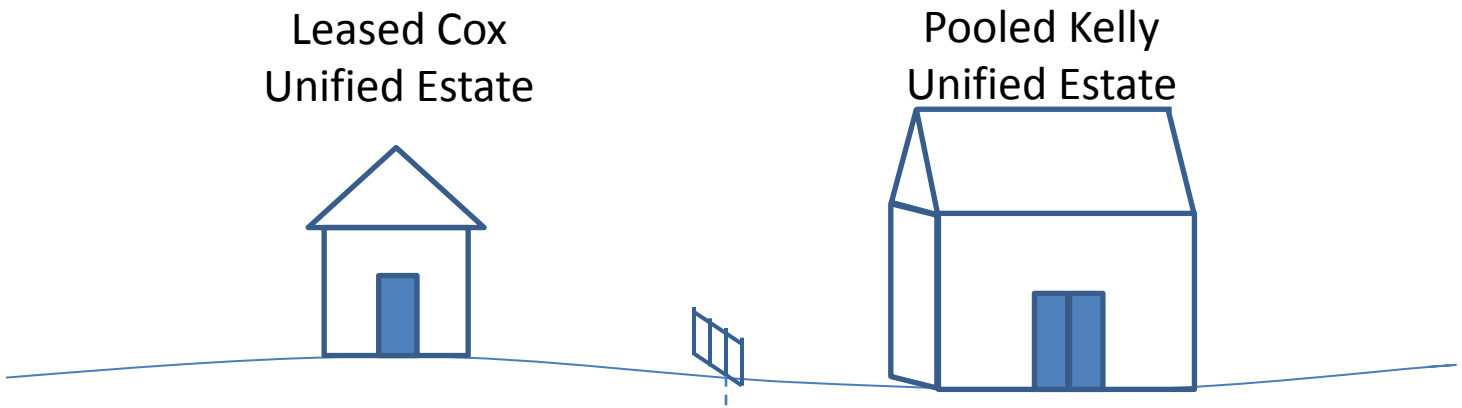
Cox Lease

- **Sounds and vibrations** from seismic work to be muffled to protect occupants and livestock
- **Remediation:** Operator agrees to return property to original condition within set time

Current State rules

- No limits on sound and vibrations
- No remediation required from testing activities

Rules governing development and production of pools



1. Operator survey and seismic test (cont.)

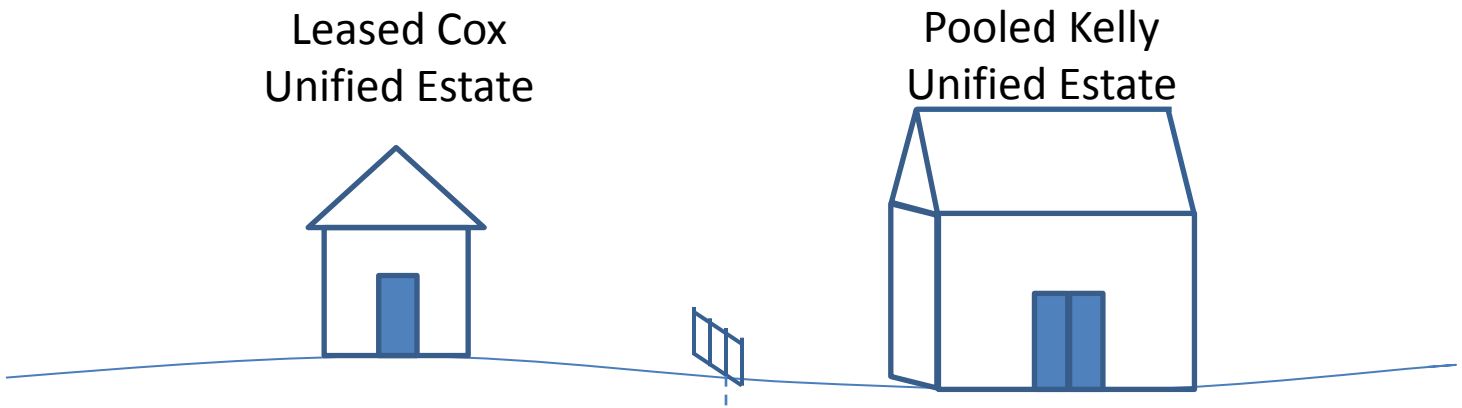
Cox Lease

- **Liability:** Operator strictly liable and agrees to indemnify landowner against any claims or regulatory enforcement actions
- **Dispute resolution** methods agreed to

Current State rules

- No shifting of risk to operator
- No dispute resolution methods agreed to

Rules governing development and production of pools



1. Operator survey and seismic test (cont.)

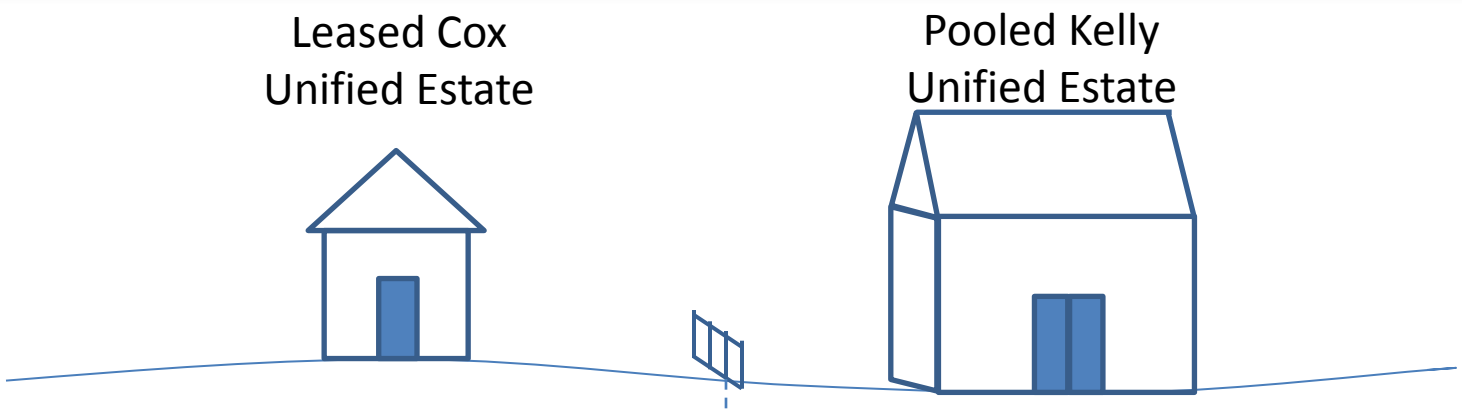
Cox Lease

- **Insurance:** Operator to maintain prescribed amount of worker's comp, employer's liability, comprehensive general liability, and business auto and vehicle liability insurance

Current State rules

- Minimal if any insurance liability required for survey and seismic testing activities

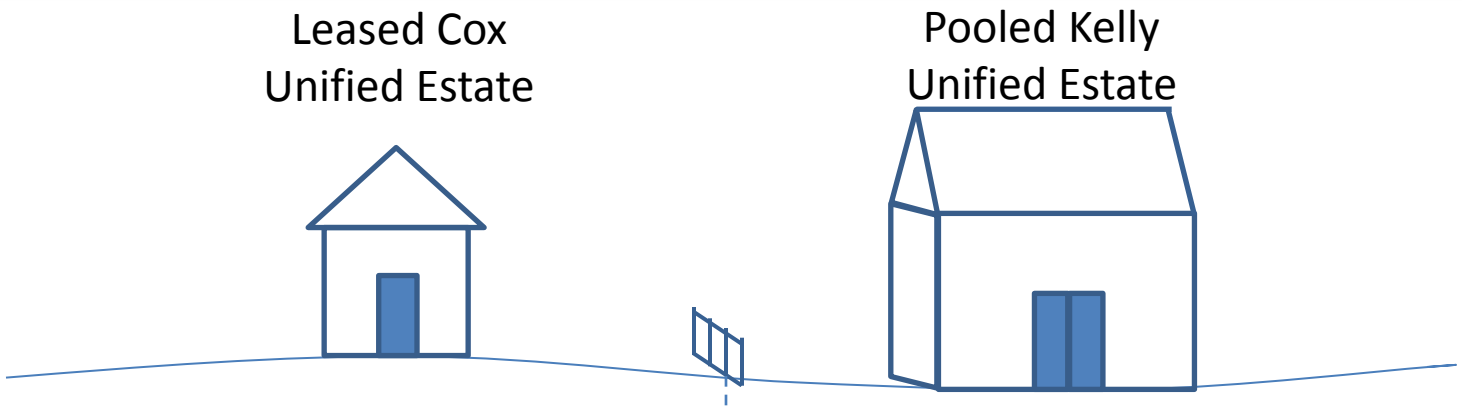
Rules governing development and production of pools



Scene 2:

Environmental consultant arrives to begin gathering of baseline data

Rules governing development and production of pools



2. Baseline data collection and environmental monitoring

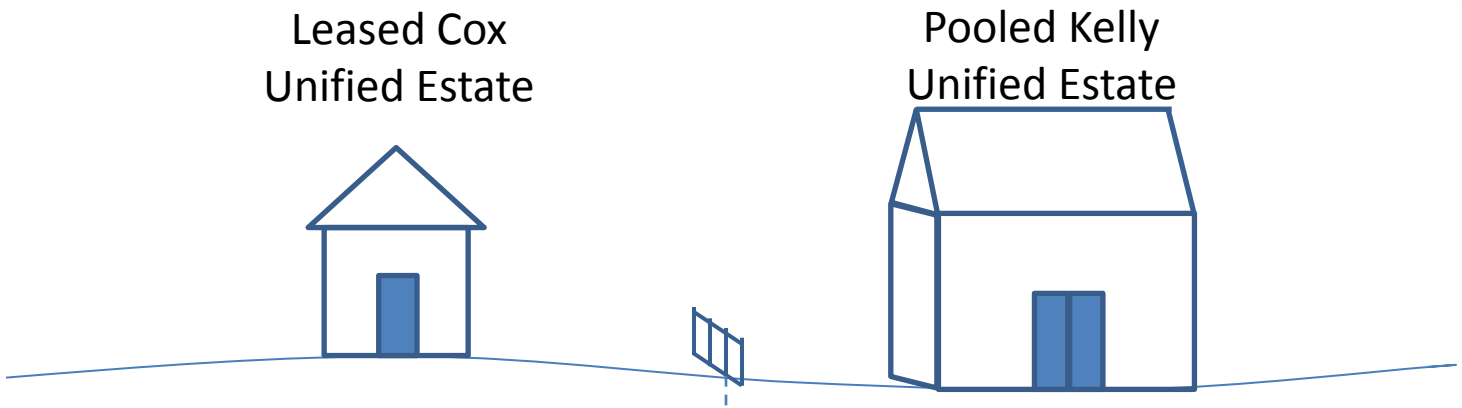
Cox Lease

- Requires specific schedule, locations, and disclosure of monitoring groundwater, surface water, soil, and air
- Original survey documents to be provided to landowner

Current State rules

- Baseline testing and monitoring required but standards not established and may be less rigorous that what landowner would negotiate [§2(c)]
- No requirements to provide survey documents

Rules governing development and production of pools



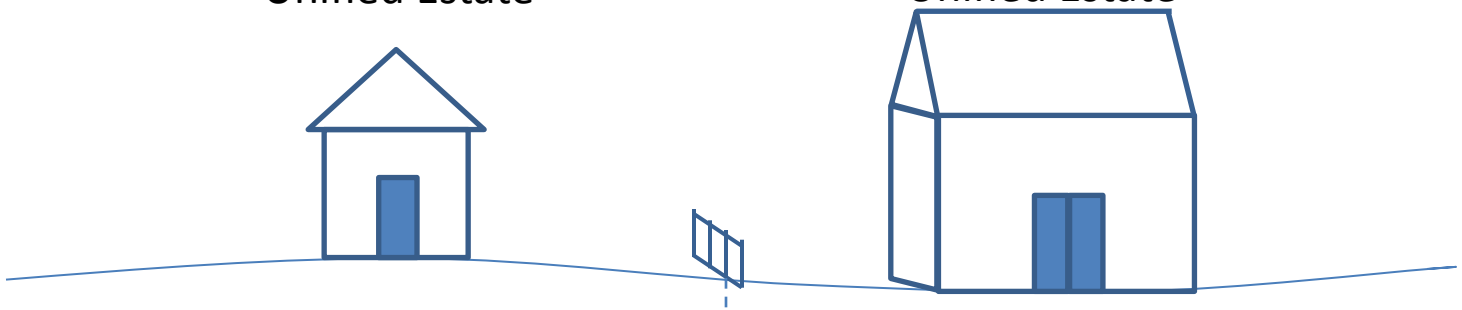
Scene 3:

Sanford Herald has article about operator transferring some leases. Inquiries to operator yield no reply until letter from new company arrives.

Rules governing development and production of pools

Leased Cox
Unified Estate

Pooled Kelly
Unified Estate



3. Limits on transfer of lease

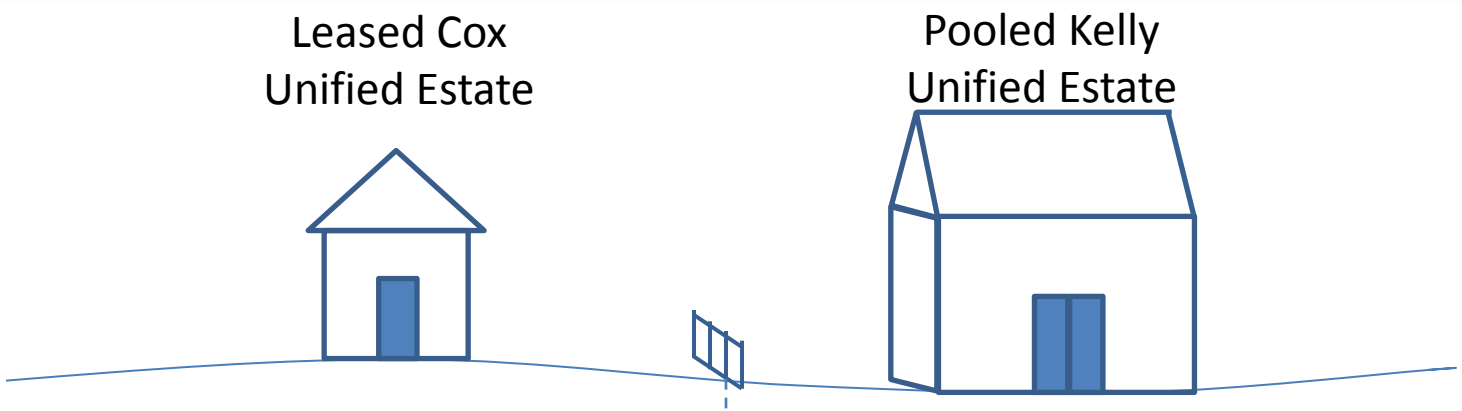
Cox Lease

- Advance notice to mineral rights owner of lease transfer or written consent of mineral rights owner prior to transfer

Current State rules

- Notice of lease assignment required within 30 days [§4(d)]
- No restrictions on lease transfer

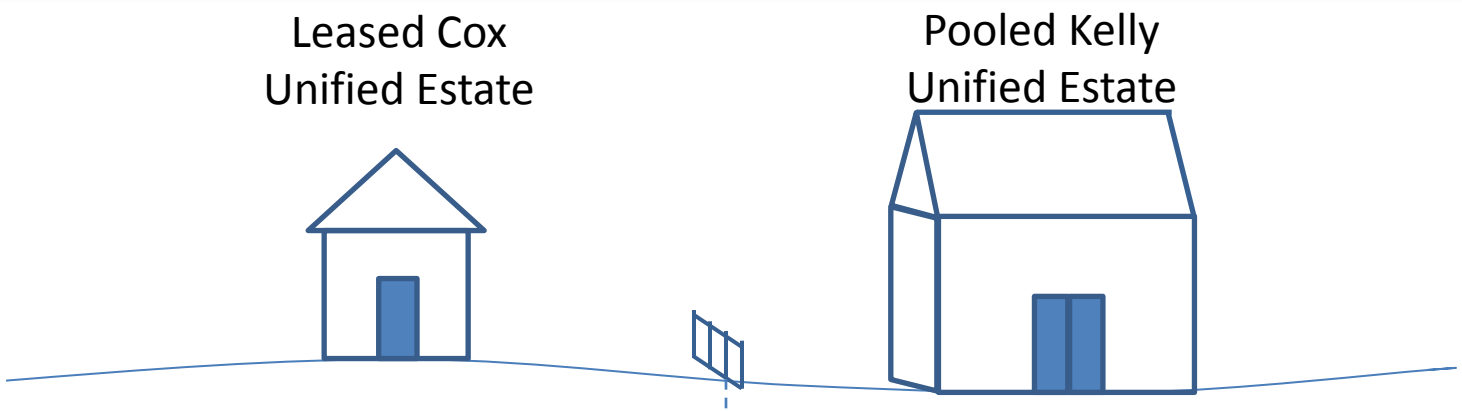
Rules governing development and production of pools



Scene 4:

Three years pass.

Rules governing development and production of pools



4. Renewal Terms

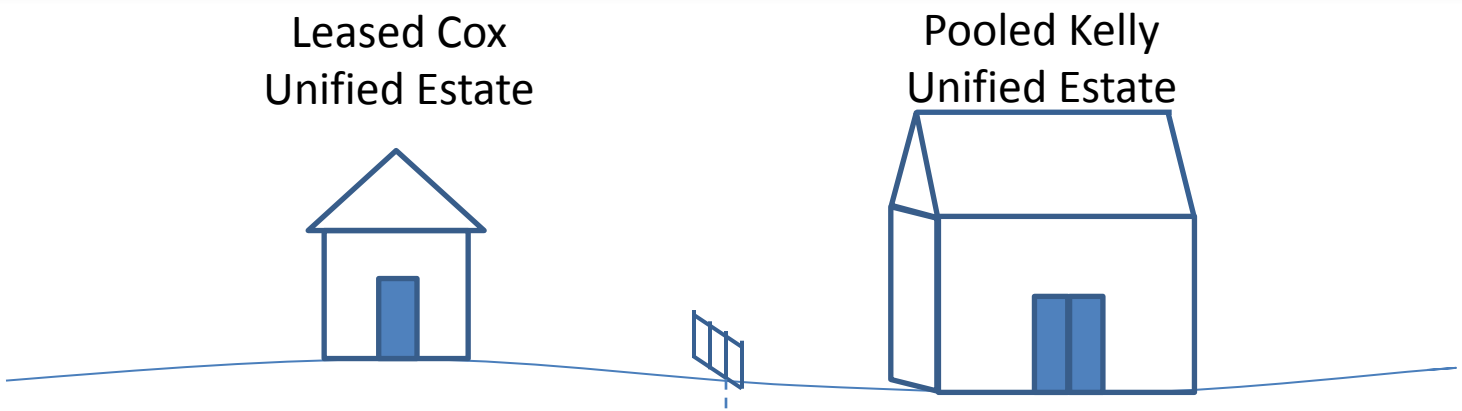
Cox Lease

- 3-year lease not renewed unless "drilling operations" have commenced. If no operations, can negotiate new lease.
- No force majeure clause renewal at 3 years

Current State rules

- 10-year lease term
- No standard of "bit in ground" or "strata reached" provisions to trigger lease renewal
- Force majeure clause operational for ten years [§4(d)]

Rules governing development and production of pools



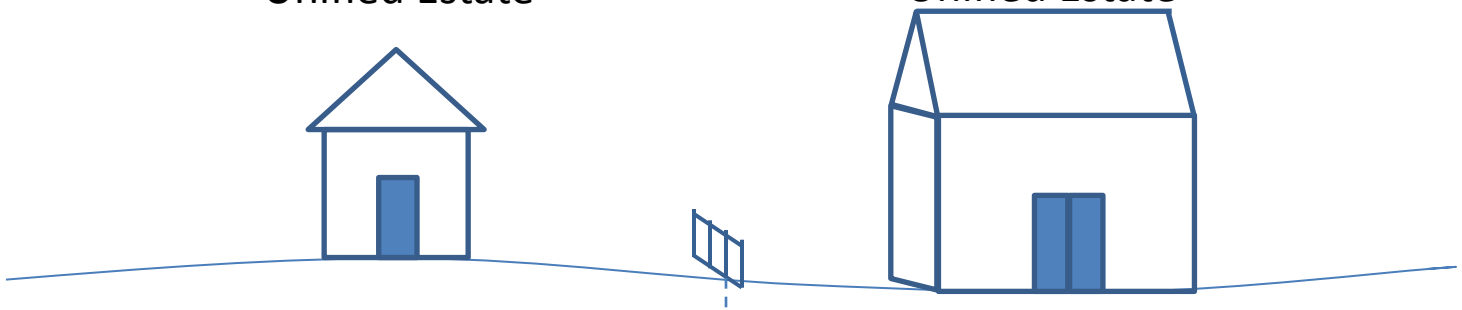
Scene 5:

3 years pass. Drilling finally begins.

Rules governing development and production of pools

Leased Cox
Unified Estate

Pooled Kelly
Unified Estate



5. Surface Use Agreement Standards – Construction Phase

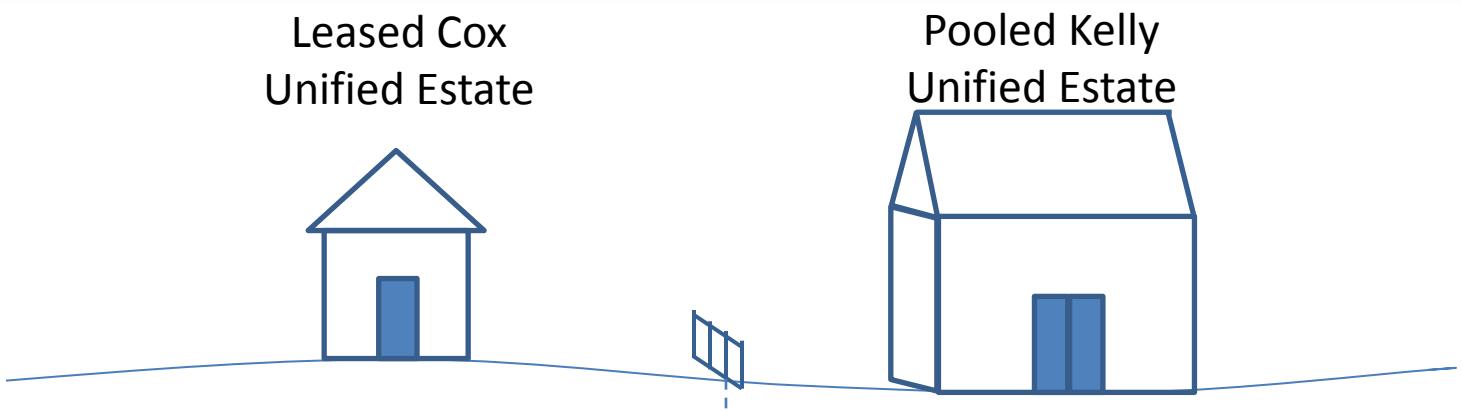
Cox Lease

- Written construction land-use plan containing setbacks from buildings and water agreed to and provided to landowner
- Lights and noise impacts minimized
- Right of inspection of construction

Current State rules

- No timeline or written plan for construction provided
- No agreement on mitigation of light and noise from construction phase
- No right of inspection

Rules governing development and production of pools



5. Surface Use Agreement Standards – Construction Phase (cont.)

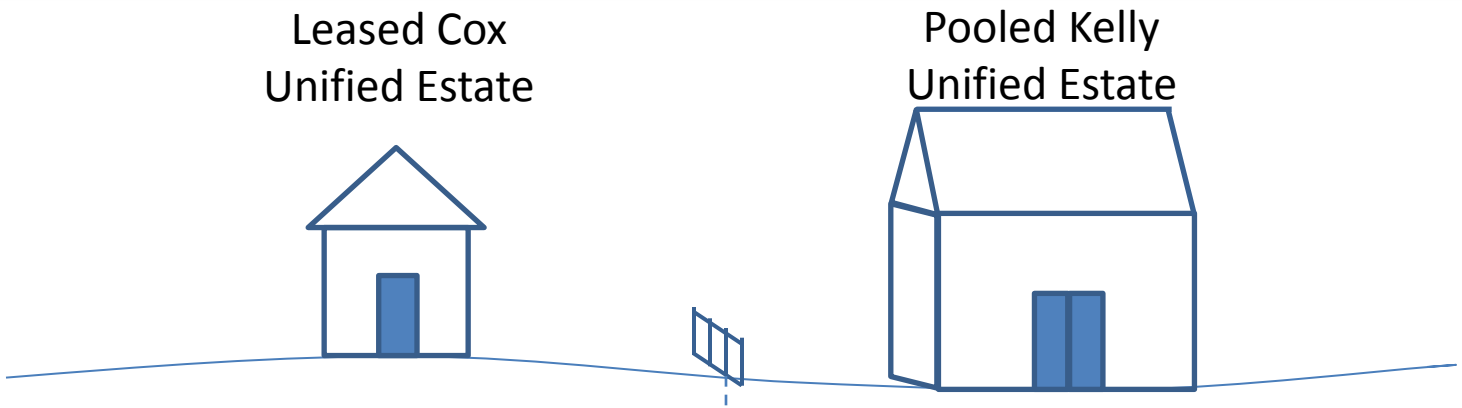
Cox Lease

- Operator pays fair market value for all timber, crops, and structures (including fences and gates) removed or damaged
- Temporary fencing , drainage and erosion control measures agreed to and established

Current State rules

- No compensation schedule or valuation method for damage established
- No temporary fencing set up
- No erosion control measures agreed to

Rules governing development and production of pools



5. Surface Use Agreement Standards – Construction Phase (cont.)

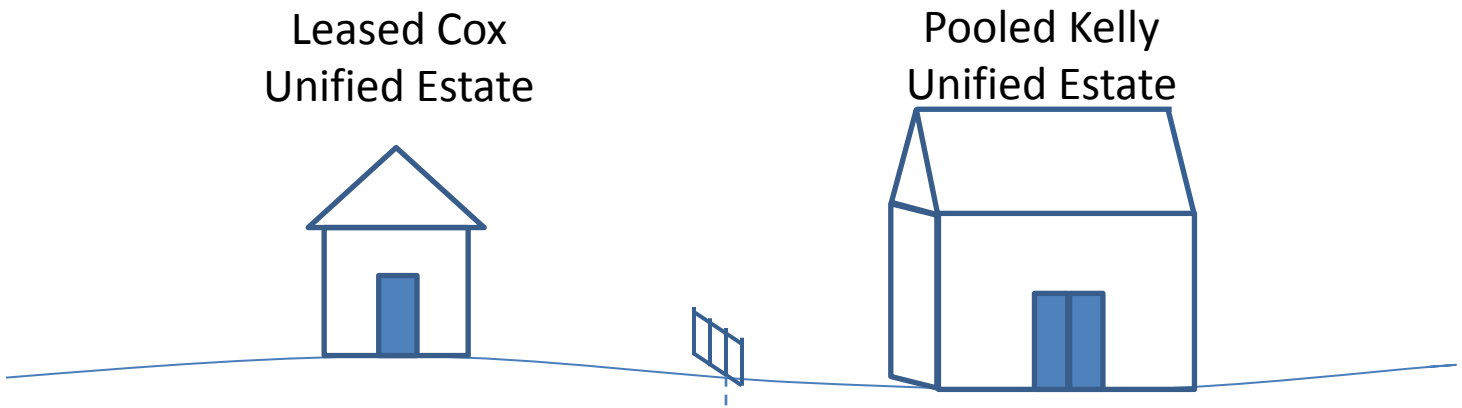
Cox Lease

- Soil quality maintained through double ditching to separate top soil and subsoil
- Soil compaction avoided
- Rocks removed from surface where unearthed

Current State rules

- No provisions for soil quality protection or avoiding soil compaction made

Rules governing development and production of pools



5. Surface Use Agreement Standards – Construction Phase (cont.)

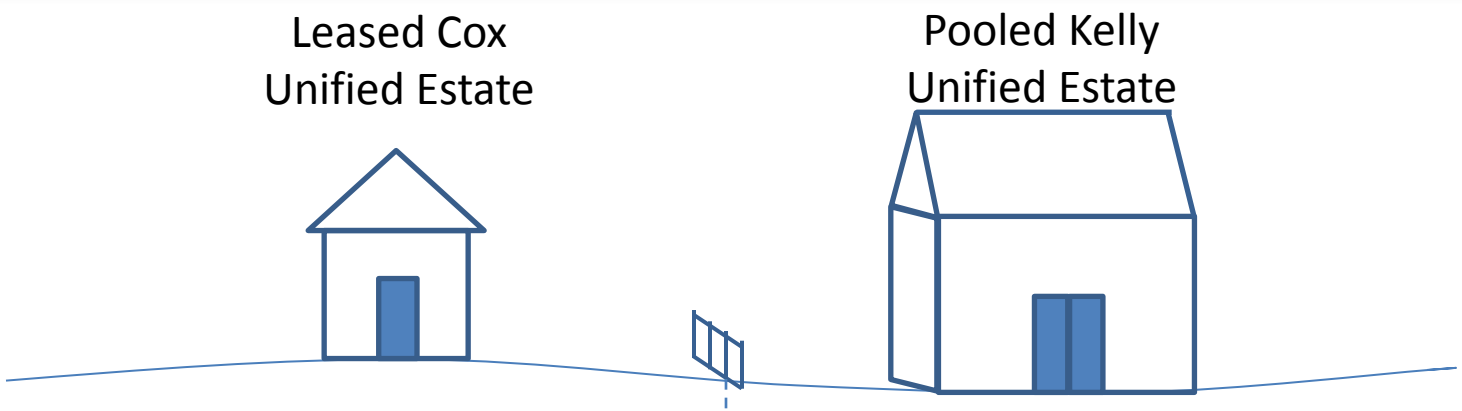
Cox Lease

- Lease must specify allowable water use, not conflict with landowner water usage, and provide for fair market value for water [§4(d)]

Current State rules

- Lease must specify allowable water use, not conflict with landowner water usage, and provide for fair market value for water [§4(d)]

Rules governing development and production of pools



5. Surface Use Agreement Standards – Construction Phase (cont.)

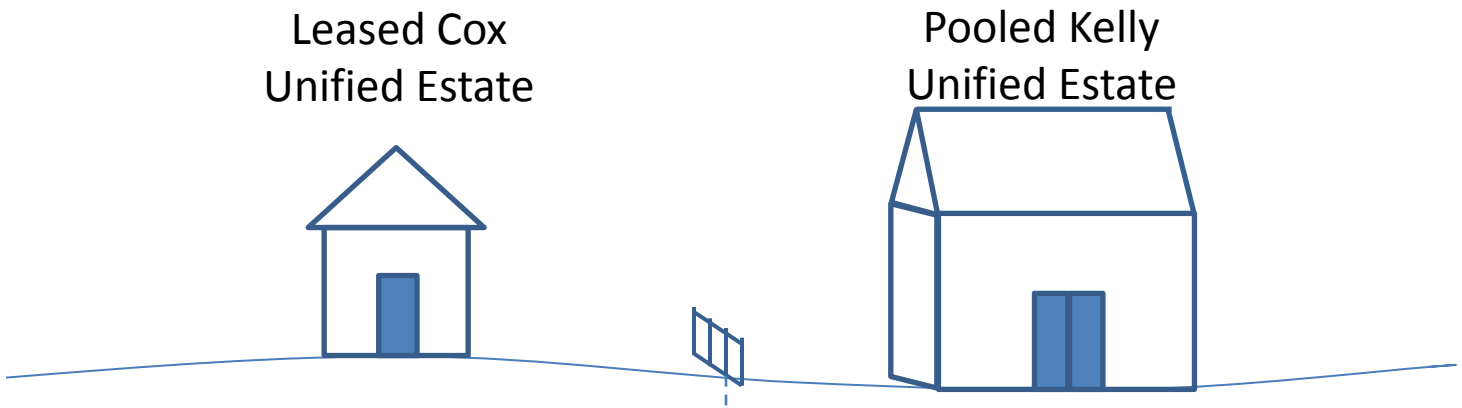
Cox Lease

- Plans, timeline, and payment schedule for infrastructure development beyond well
- Specific easements for appurtenant infrastructure granted with geographic, height, and depth limits

Current State rules

- No provisions for additional infrastructure development
- No limits on infrastructure development rights arising from pooling rights

Rules governing development and production of pools



5. Surface Use Agreement Standards – Construction Phase (cont.)

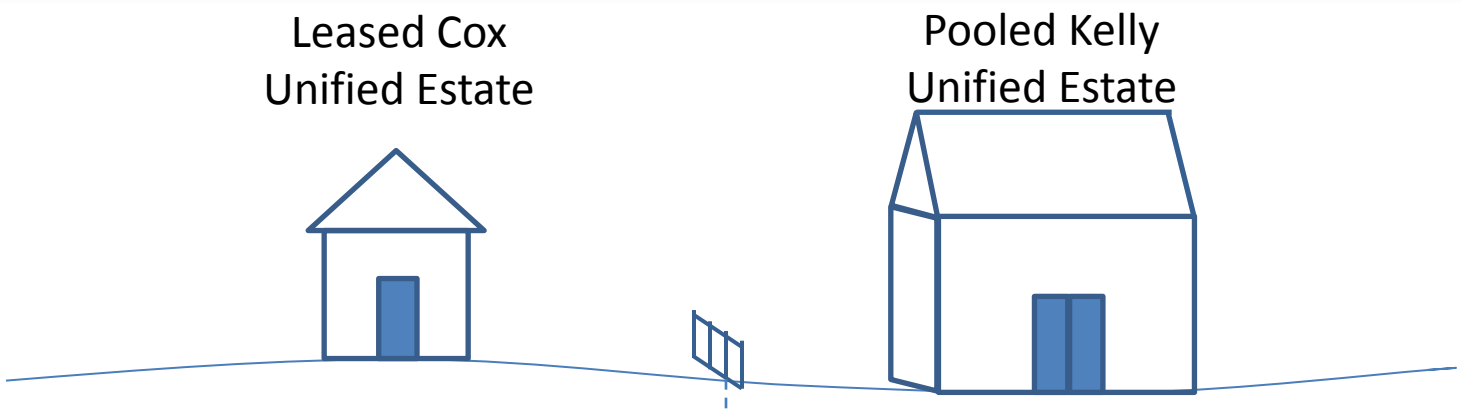
Cox Lease

- Production phase land-use plan agreed to in writing
- Reclamation plan agreed to in writing
- Drilling and construction phase damages valued and paid

Current State rules

- No written production phase land-use plan prepared
- No written reclamation plan agreed to
- No drilling and construction damages measured and paid

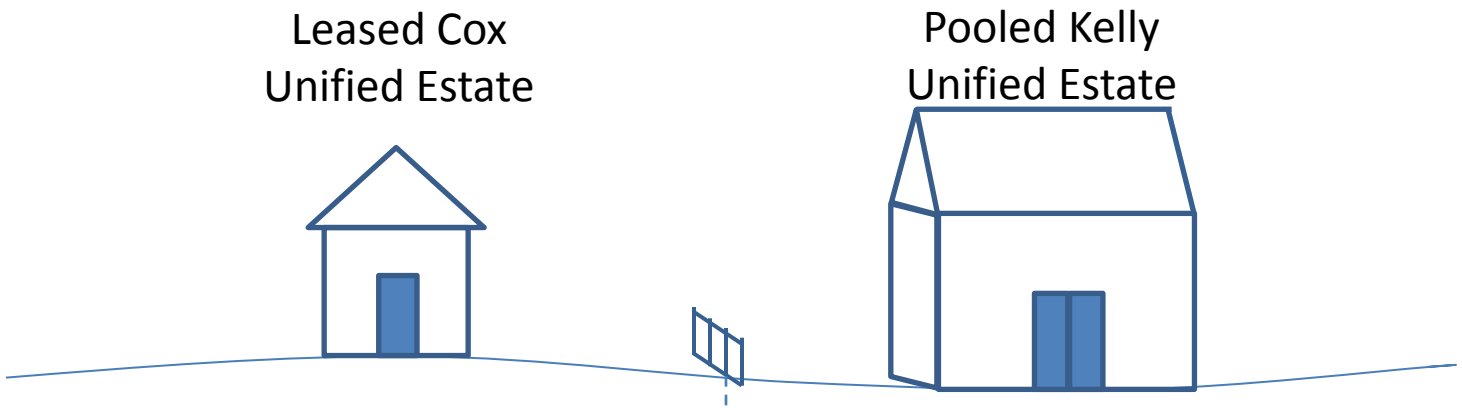
Rules governing development and production of pools



Scene 6:

Check arrives in the mail from operator.

Rules governing development and production of pools



6. Receive a royalty check – is it for the right amount?

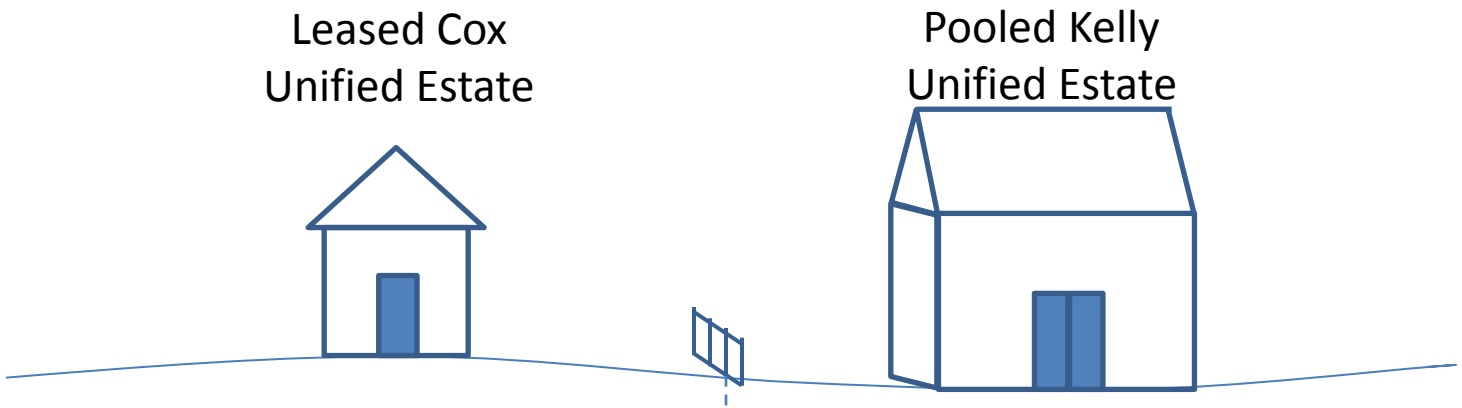
Cox Lease

- After bonus check for acreage, monthly royalty payments above statutory minimum once production starts
- Royalties paid without deductions on greater of market value or gross proceeds

Current State rules

- No bonus payment ever received
- 12.5% statutory minimum royalty received

Rules governing development and production of pools



6. Receive a royalty check – is it for the right amount? (cont.)

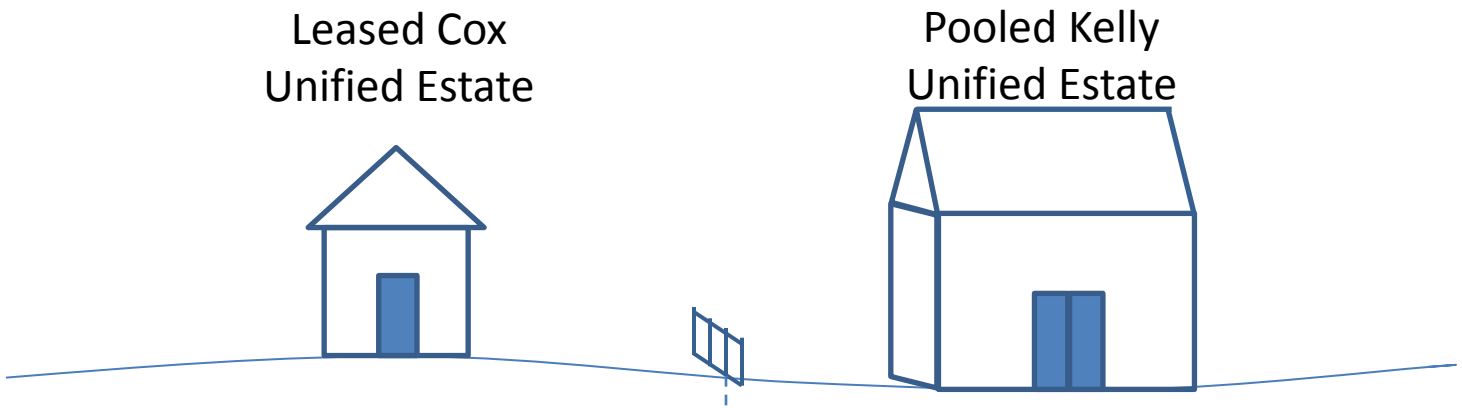
Cox Lease

- Royalty statement includes lessor name; lessor's ID #; lease #; well and property name; API #; month and year of sale; oil, gas, and NGL volumes; price per barrel or MMBtu; taxes; lessor's interest, share of sale, deductions & codes

Current State rules

- No details required on payments

Rules governing development and production of pools



6. Receive a royalty check – is it for the right amount? (cont.)

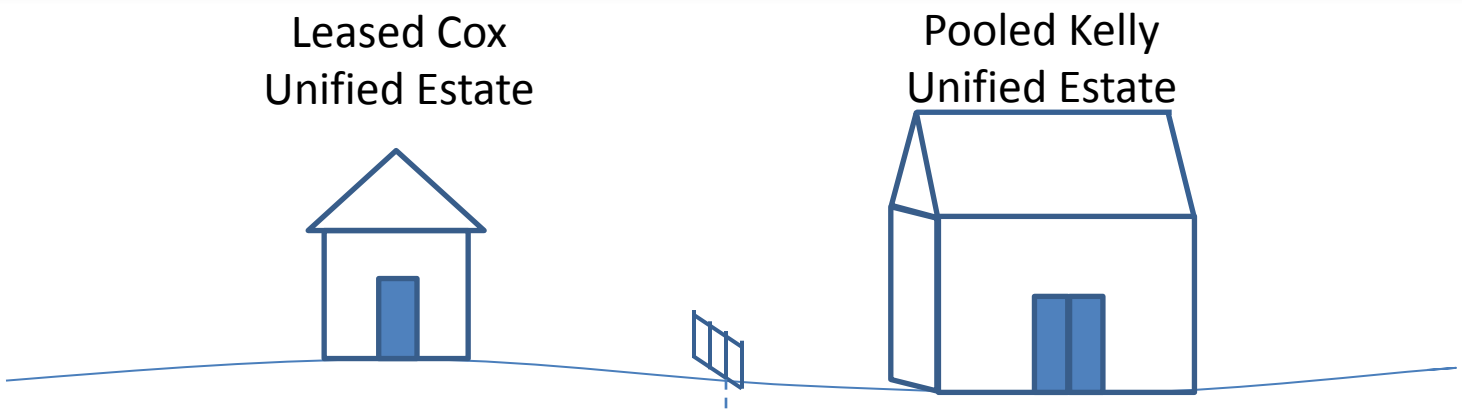
Cox Lease

- Right of royalty audit can be exercised
- Rents paid for use of lands
- Lease terms supecede any Division Order language

Current State rules

- No royalty payment audit rights
- No rental payments for surface use of land

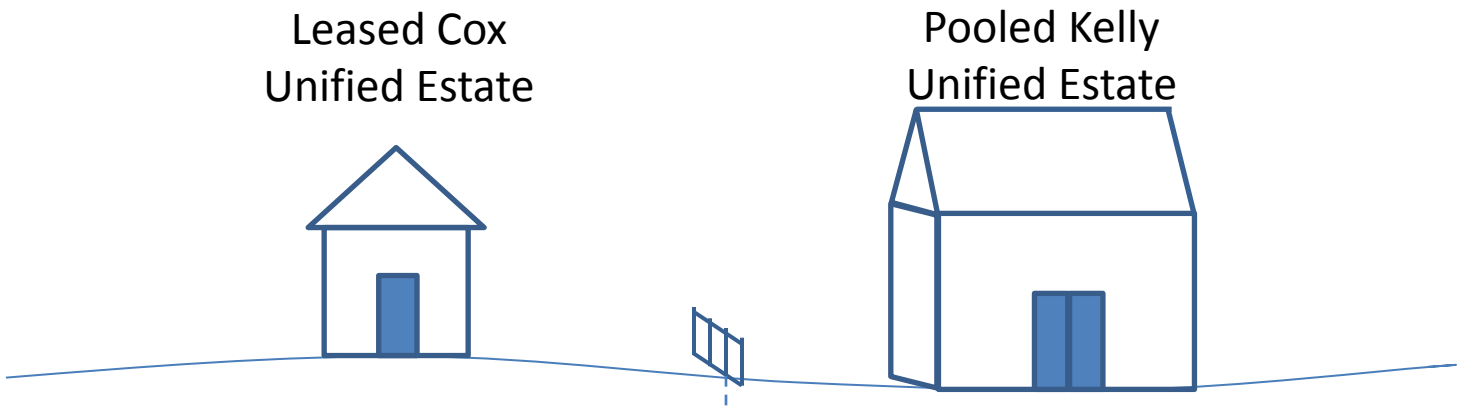
Rules governing development and production of pools



<u>Scene 7:</u>

Stranger drops in for coffee. Tenders offer for gas and hunting lease above undeveloped portion of mineral estate.

Rules governing development and production of pools



7. Who can lease out undeveloped portions of land?

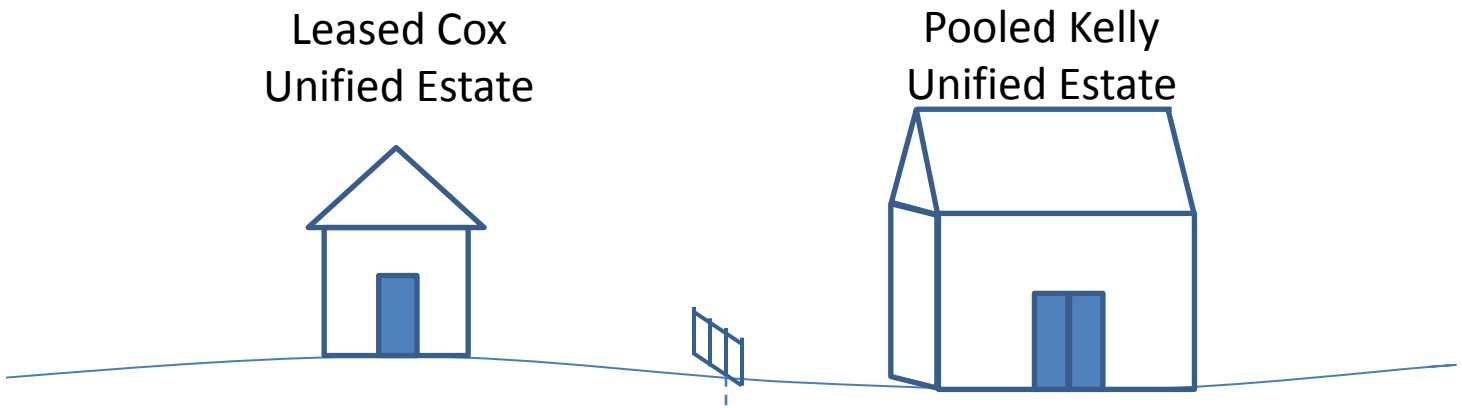
Cox Lease

- Horizontal and vertical Pugh clauses limited depth and range of minerals leased originally
- Retained acreage and depth clause frees from lease areas and zones leased but not developed

Current State rules

- No division of property allowing leasing of unused portion of land.

Rules governing development and production of pools



7. Who can lease out undeveloped portions of land? (cont.)

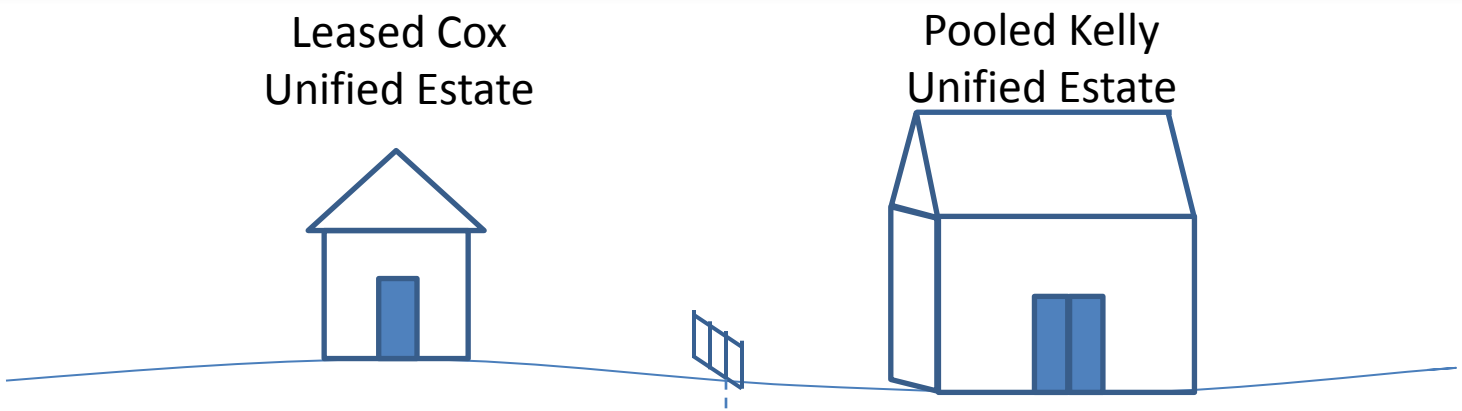
Cox Lease

- Specific contract terms retaining right of alternate uses for timber, crops, and hunting and preserving acreage for these purposes.
- Hunting rights near wellheads leased to operator.

Current State rules

- No specific terms governing alternate uses or payment for loss of alternate uses.

Rules governing development and production of pools



7. Who can lease out undeveloped portions of land? (cont.)

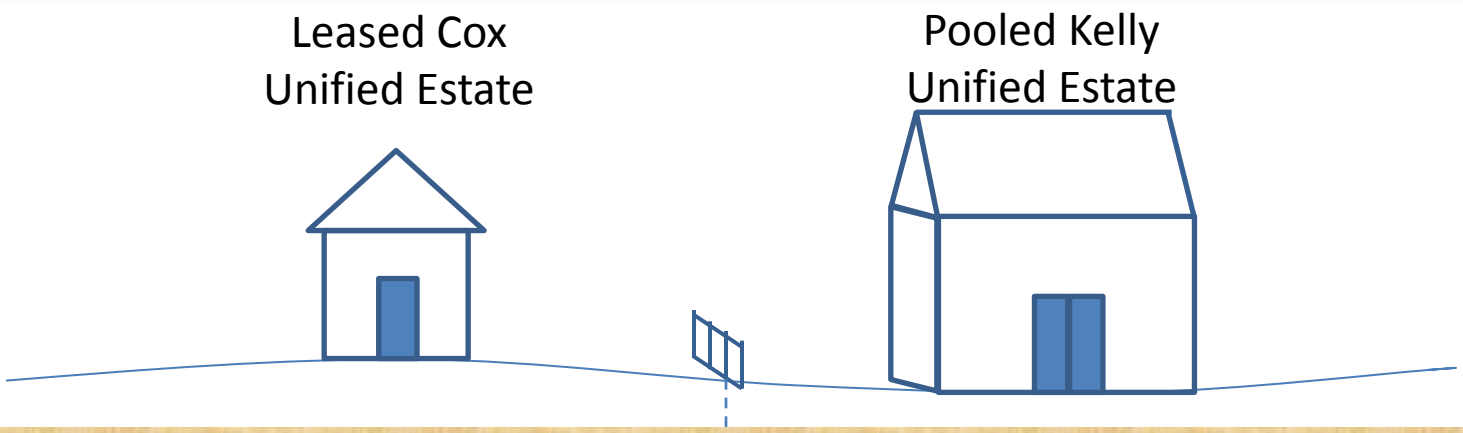
Cox Lease

- Mineral estate leased limited specifically to oil, gas, and natural gas liquids

Current State rules

- No limits on mineral types pooled specifically identified

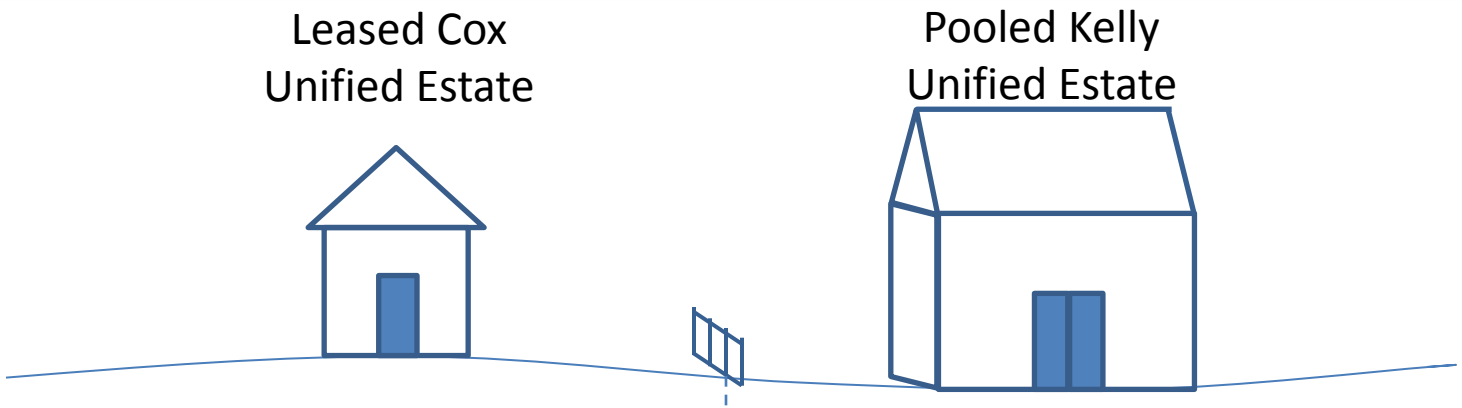
Rules governing development and production of pools



Scene 8:

Is there supposed to be a pool of oil there?

Rules governing development and production of pools



8. Responding to accidents

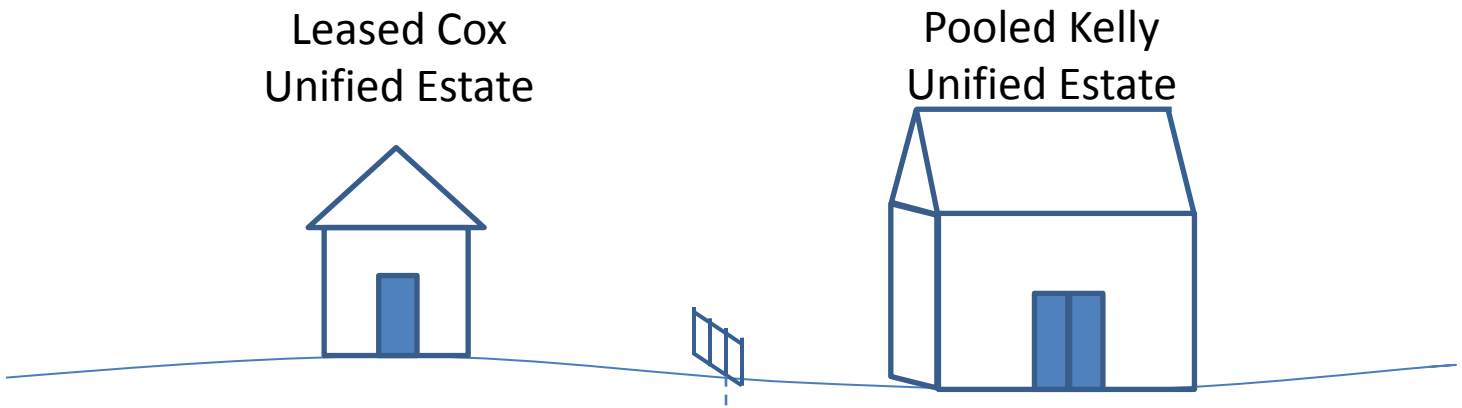
Cox Lease

- Operator must indemnify surface owner against any claims related to operator's activities on property [§4(c)]
- Adequate operator bonding, capitalization, and insurance requirements

Current State rules

- Operator must indemnify surface owner against any claims related to operator's activities on property [§4(c)]

Rules governing development and production of pools



8. Responding to accidents (cont.)

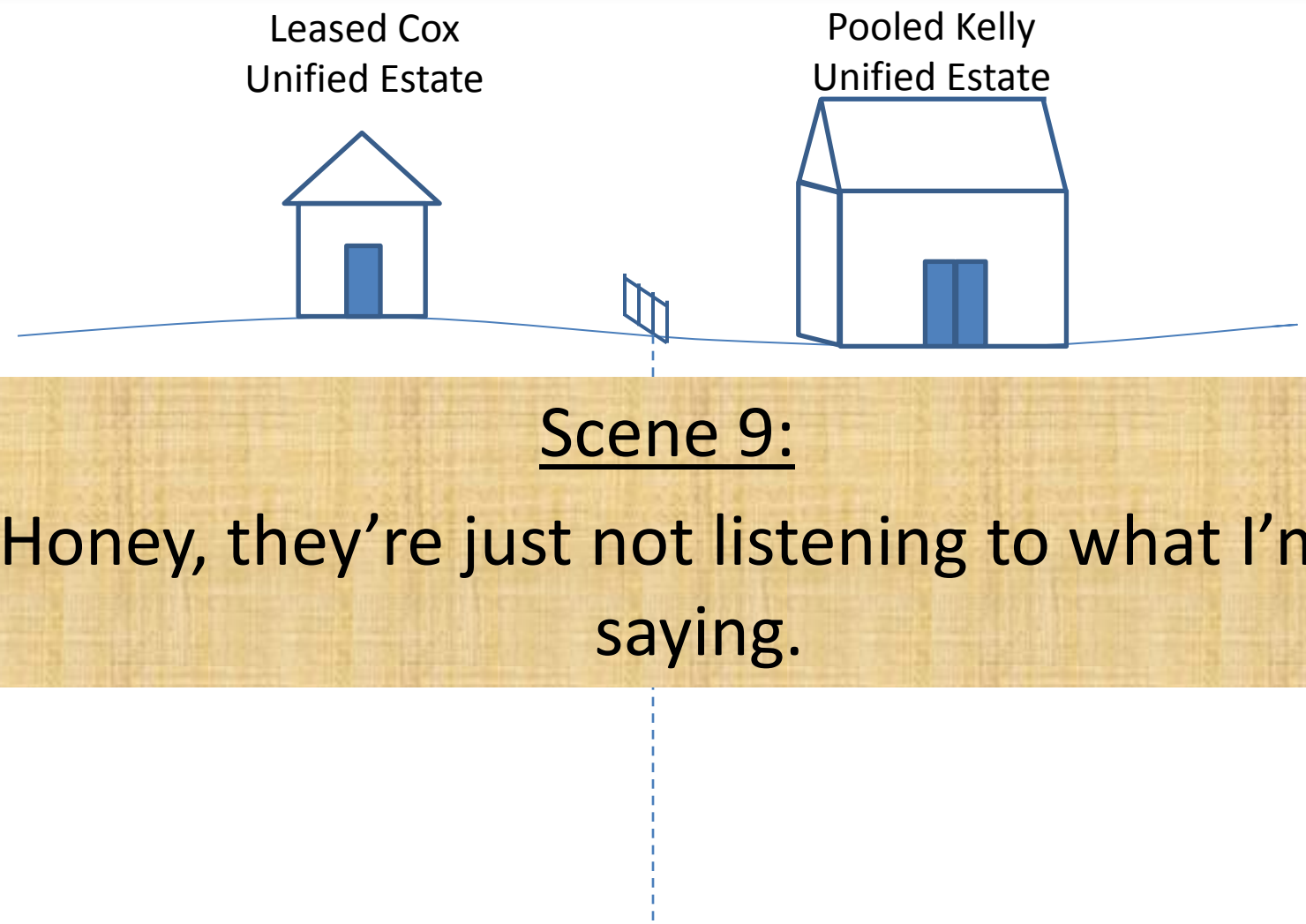
Cox Lease

- Operator must have and inform surface owner of emergency response operation plans and disclose details of all accidents
- Disclosure of hazardous chemicals used on or injected into land

Current State rules

- Operator must indemnify surface owner against any claims related to operator's activities on property [§4(c)]
- Disclosure of hazardous materials to emergency responders and regulators

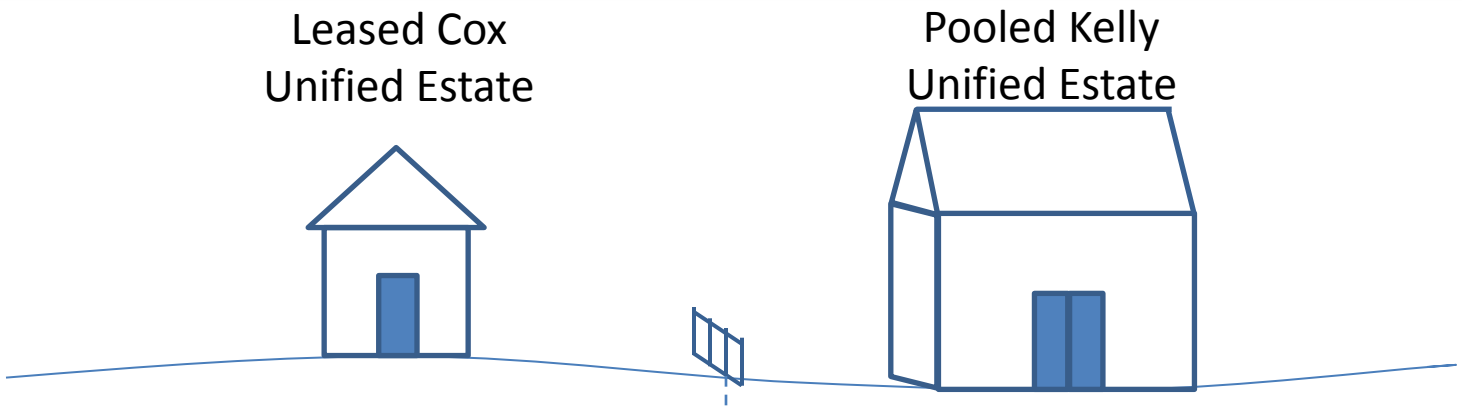
Rules governing development and production of pools



Scene 9:

Honey, they're just not listening to what I'm saying.

Rules governing development and production of pools



9. Dispute resolution process agreed upon

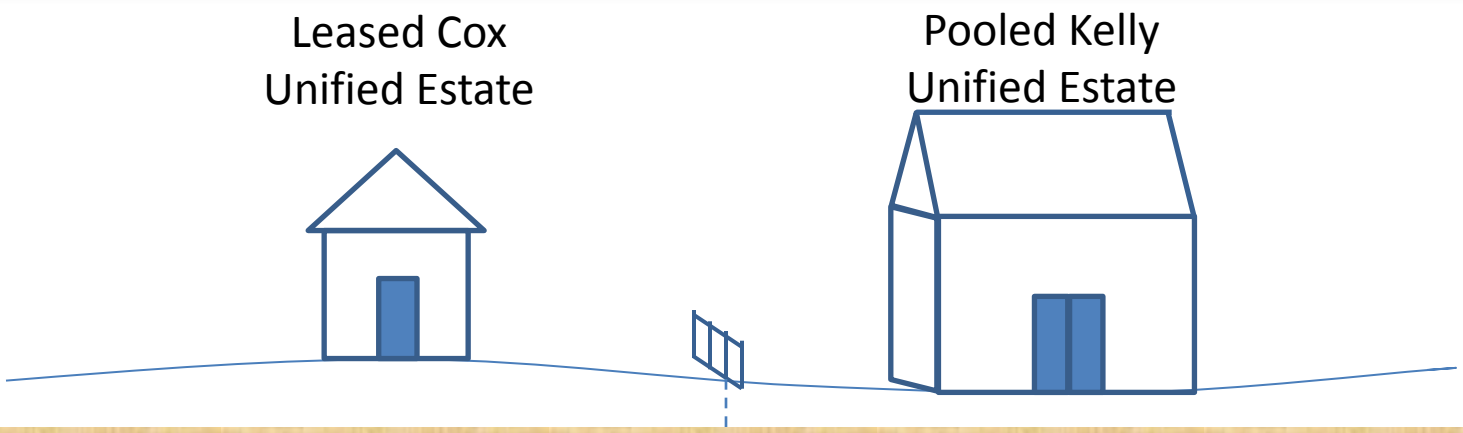
Cox Lease

- Operator agrees in writing to best efforts to resolve dispute, mediation, then court proceedings in county in which well located

Current State rules

- No dispute resolution procedures identified

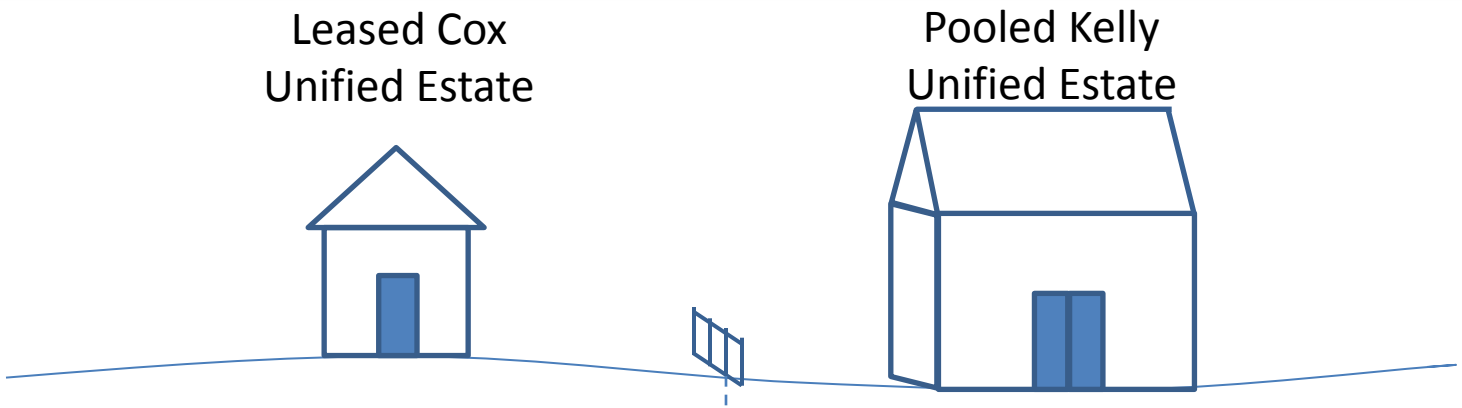
Rules governing development and production of pools



Scene 10:

Then one day, the pump stopped.

Rules governing development and production of pools



10. Payments and renewals when operations are suspended

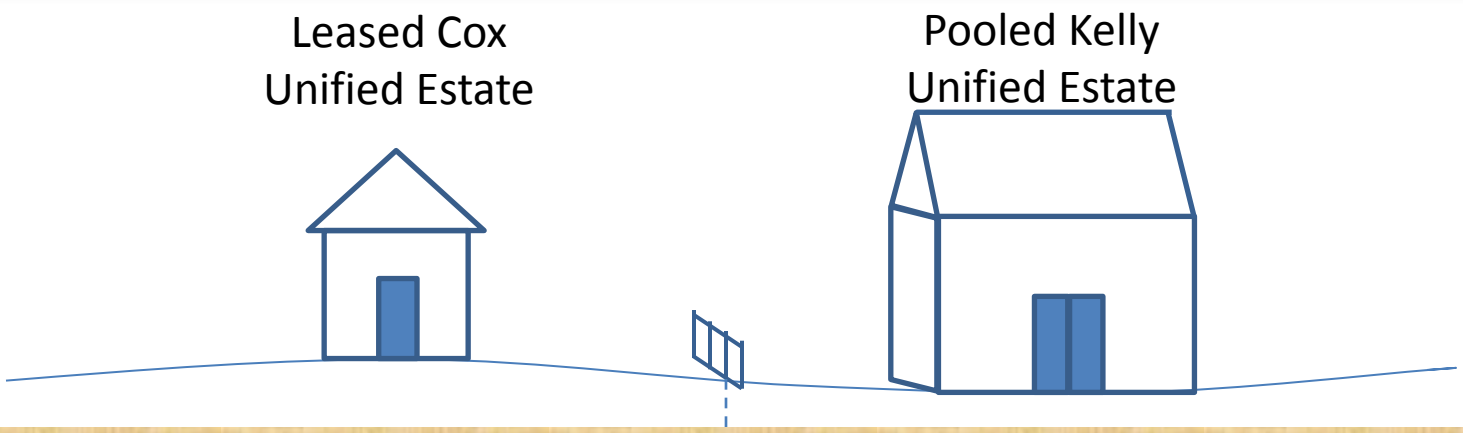
Cox Lease

- Habendum (continuous operations) clause releases mineral estate when production stops.
- If well shut-in or flow reduced temporarily, shut-in royalties paid.

Current State rules

- No lease provision protecting shutting-in of production

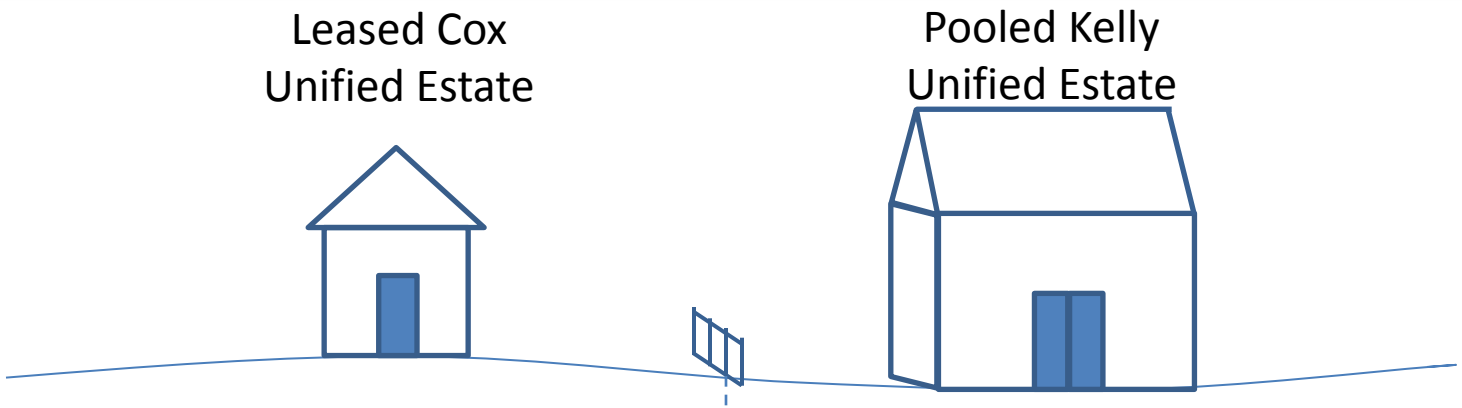
Rules governing development and production of pools



Scene 11:

When you were a little girl . . . .

Rules governing development and production of pools



11. Reclaiming and restoring land

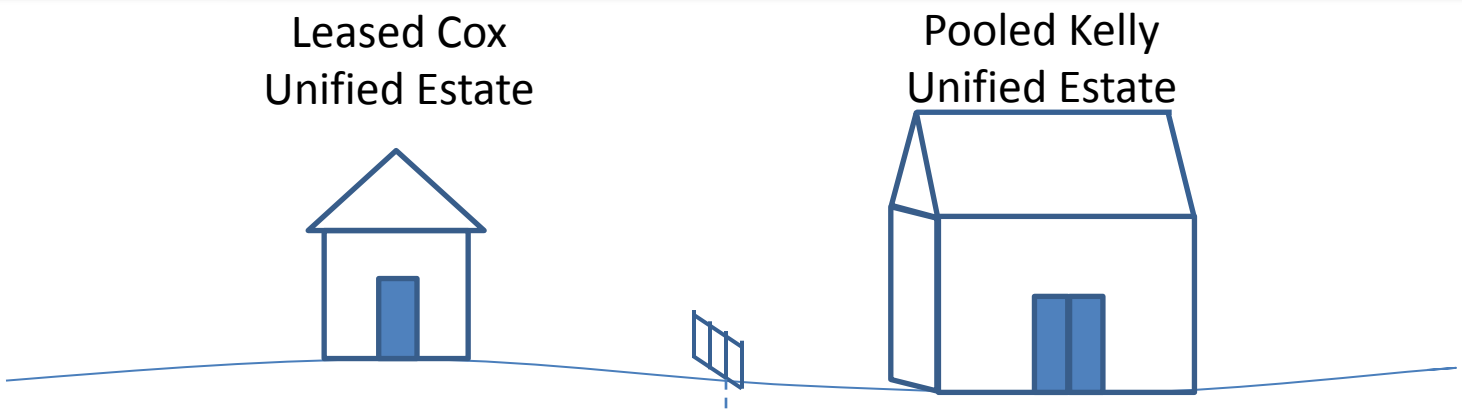
Cox Lease

- Detailed written reclamation and monitoring plan
- Warranty of adequate operator capitalization and operator bonding to cover reclamation and ongoing monitoring

Current State rules

- No reclamation plan
- Requirement that operator provide financial assurance of well closure, reclamation, ongoing monitoring [§2(c)]

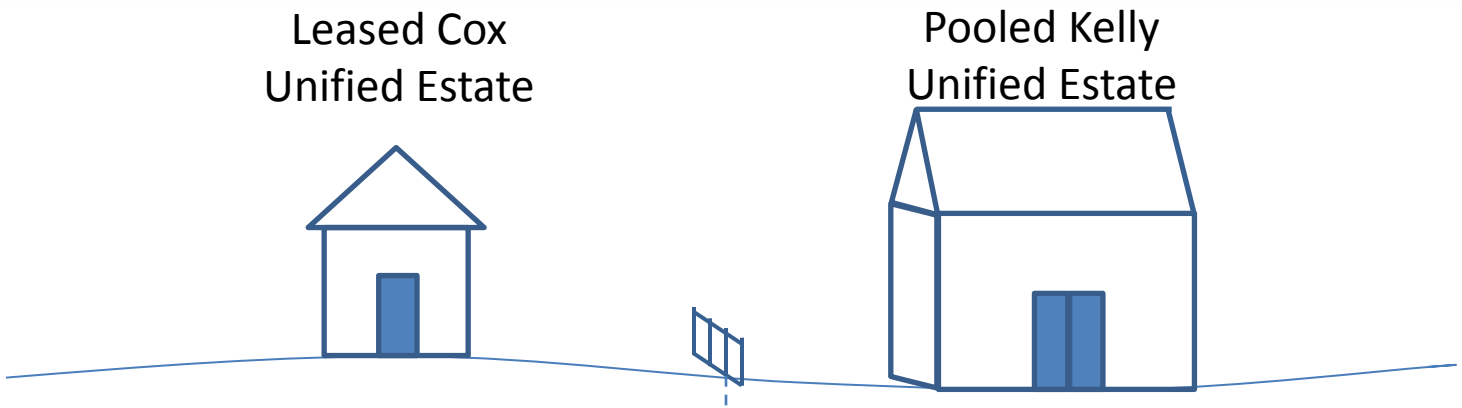
Protecting Landowners in the Law



Conclusions

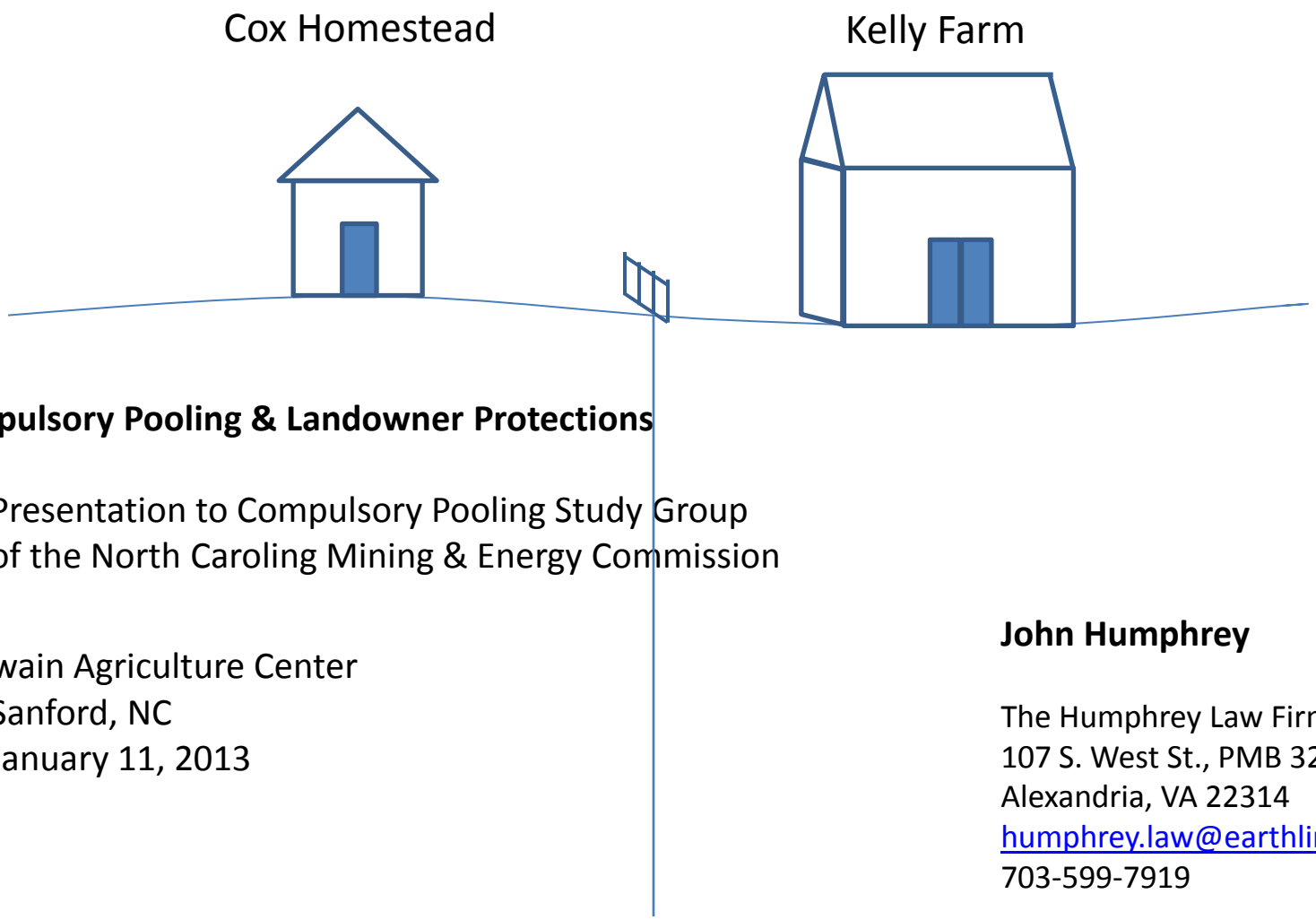
- Under current NC law, landowners compelled into a pool have significantly fewer opportunities to protect themselves than those who negotiate their leases.
- Compelling the granting of surface and subsurface easements affects a wider range of landowner rights than compulsory pooling alone.

Protecting Landowners in the Law



Conclusions

- If a compulsory pooling rule that compels granting surface or subsurface easements is implemented, the State should integrate into pooling orders the full array of measures generally available in oil and gas leases to protect owners of any pooled mineral estate or appurtenant surface estate, whether unified or severed.



Compulsory Pooling & Landowner Protections

Presentation to Compulsory Pooling Study Group
of the North Caroling Mining & Energy Commission

McSwain Agriculture Center
Sanford, NC
January 11, 2013

John Humphrey

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