2019 HOUSE JUDICIARY

HCR 3013

2019 HOUSE STANDING COMMITTEE MINUTES

Judiciary Committee
Prairie Room, State Capitol

HCR 3013
2/27/2019
32922

☐ Subcommittee
☐ Conference Committee

Committee Clerk: DeLores D. Shimek

Explanation or reason for introduction of bill/resolution:

Relating to exercising eminent domain over certain mineral rights and pore space for the benefit of private industry; and to amend and reenact section 16 of article 1 of the Constitution of ND; relating to an exception to the limitations on exercising eminent domain.

Minutes: 1

Chairman Koppelman: Opened the hearing on HCR 3013.

Rep. M. Nelson: (Attachment #1) Read testimony. I would argue that in 2006 much of our entire development in the bakken has been unconstitutional and puts the industry at risk. The idea is if you permit this to go forward it would go to the people of ND for a vote and if this doesn't get passed I would think the Industrial Commission should cease any forced pool, but we don't have a court case yet, but we probably will.

Chairman K. Koppelman: On page 2 of the bill on line 11 the words not to be taken for the use of. How do you interpret those words?

Rep. Nelson: You control your private property and it can't be used by someone else through eminent domain without your permission. Section 1 on the bill everything is just updated wording except on line 10; except as provided in Section 26 so you don't have to worry too much about that. When forced pooling happens you do not have a choice about having your oil extracted. You can get into different types of compensation and how well they are compensated, but that is not really a topic for this. Just like you can't take the grocery store anymore and give it to another grocer to build a grocery store; well you paid me a fair price for it. That is just not allowed and the same would apply here.

Chairman K. Koppelman: Could you take the grocery store under the guise that we are going to widen the street so therefore we have to take this property?

Rep. Nelson: The original taking is for the street; which is a public use which would be allowed. It gets arguable if you back off, if it is not used for the purpose for which it was taken. I do believe there have been times when things have been taken for public use and haven't been used for that particular use. I don't know of any where they have been converted to private use afterward.

Chairman K. Koppelman: The scenario we thought of at the time with that measure was in Grand Forks during the flooding they had to acquire lots to do diking. There was a big chuck of land that was left over after that public purpose so they could replot it and re-subdivide it to create new residential lots and resell to private parties for purpose of private use. I think under this section of the constitution you could argue that it was unconstitutional.

Rep. Nelson: I think as long as the public use I don't think they would rule that as unconstitutional.

Chairman K. Koppelman: If we are amending this section maybe we should make that clearer.

Rep. McWilliams: There are a couple of places where shall has been changed to may?

Rep. Nelson: Yes shall and may have opposite means as the may not and shall. It is a style update. It doesn't change the meaning.

Rep. Jones: Are you contemplating the industrial commission taking ownership of the minerals? Is that what this is doing?

Rep. Nelson: Right now the Industrial Commission gives the order and does the pooling. Could the state of ND start taking oil? Yes. they could do this today. We would have to have some public use for it. This is where they do some pooling and some oil company and takes those minerals.

Rep. Jones: I think they facilitate accessing the minerals. They don't actually take the ownership, but they are the authority that basically allows them to access and develop the oil.

Opposition: None

Neutral: None

Hearing closed.

2019 HOUSE STANDING COMMITTEE MINUTES

Judiciary Committee
Prairie Room, State Capitol

HCR 3013
3/4/2019
33152

☐ Subcommittee
☐ Conference Committee

Committee Clerk: DeLores D. Shimek

Explanation or reason for introduction of bill/resolution:

Relating to exercising eminent domain over certain mineral rights and pore space for the benefit of private industry; and to amend and reenact section 16 of article 1 of the Constitution of ND; relating to an exception to the limitations on exercising eminent domain.

Minutes: 1,2,3,

Chairman Koppelman: Opened the meeting on HCR 3013. Mr. Helms was here on the hearing and wanted to get more information and approval from his bosses so he is back here and handed out some material and I told him I would allow him to present that to the committee so we are aware of their input.

Opposition:

Lynn Helms, Dept. of Minerals Resource Director, Industrial Commission: (Attachment 1,2,3) I was here for the hearing and did not have approval to address the resolution from the Industrial Commission. I now know they are opposed to the resolution. Went over testimony and handouts. I realize you are not taking additional testimony. (Attachment 1 was from our legal counsel) Forced pooling was not eminent domain. This resolution would be inappropriate in addressing those.

Chairman K. Koppelman: How does forced pooling really work?

Lynn Helms: Went over Attachment #2 (2:54-6:57) Went over this information. The last document just deals with how all the different states do it.

Chairman K. Koppelman: When you talk about the liquid minerals moving; my understanding of the fracking process is you are going into the rock; injecting the fracking material; which fractures the rock and that is when the oil is released. Do those move unless they are fracked?

Lynn Helms: Yes, conventional resources will move in the absence of hydraulic fractures. Those pore spaces are all interconnected and you can't stop them from moving. Unconventional resources will not move in the absence of hydraulic fracturing, but having been fractured they will move at will and be extracted by that well bore in the spacing unit.

In order to avoid someone drilling and fracturing a well and extracting the neighbors oil we exercise police powers over them and say you have to pay them based on the acreage they own.

Rep. Rick Becker: How do you determine the location, dimensions and volume of the shared pool? In order to do things equality, you need to do that, but if you were able to do that you would never be a dry well and you would know exactly how much each well would produce.

Lynn Helms: The science isn't exact, but it has come a long way, so we use three dimensional seismic to identify the shape and thickness and presents or absence of the pool. We have well data so as these horizontal wells are drilled; if they drill out of the pool it becomes obvious from the well data. Once a month we bring a company back in and change the size and shape of their spacing unit and reconfigure it. Then the old pooling order terminates and new pooling order is issued for the new spacing unit.

Rep. Rick Becker: If neighbors are involved; are they kept informed on what is happening? What is the process?

Lynn Helms: Exactly what you described happens on a regular basis. There is an application process for people to petition the commission to reconfigure the spacing unit. Usually that is initiated by the oil and gas operator who has taken the leases in the neighboring property. ND posts on these maps the exact measurements of where they are the well bore path so every individual around that well gets notice that it is being spaced and pooled. They can go on our website and see the exact well born path and where it started and ended and where it wondered. They don't have to have legal counsel to petition to appear before the commission and ask for a change before the committee. We will help them write an application and they can come to the hearing and object.

Chairman K. Koppelman: We appreciate your input. You are hear just giving us informational testimony, but also listed the Industrial Commission being opposed based upon what you shared today?

Lynn Helms: That is correct.

Rep. Jones: You make it sound like those minerals move a lot. It seems like you are always trying to drill wells very close together. Is there a rule of thumb on how far that spacing will move?

Lynn Helms: Yes there is. It is different for each reservoir. In general, it is between 500' and 660'. Over time those will migrate much further than that; up to a mile.

Rep. Rick Becker: The pore space? Doesn't this bill change who the pore space would belong to because it is supposed to belong to the property/ surface owner?

Lynn Helms: This bill does not change what was done in 2009. The land belongs to the surface owner. If it is water it belongs to the state. If it is oil or gas it belongs to the mineral owner. If it is uranium dissolved in water it belongs to the mineral owner. What we try to

address through these police power is to make sure if we damage your land or pore space you get compensated for that, but if we move the stuff that is in your pore space that doesn't belong to you. You may or may not be compensated. The cavities or pores does not. A good example is the storage of C02. Your pore space has been taken out of commission and is not useable for anything else and the landowner should be paid for it because your pore space has been taken out of commission. But if you put water into someone's pore space and it just replaces water; neither the water that went in or the water that was there belonged to the surface owner to begin with; just the cavity and solid material around it did. SB 2344 or this resolution would change that ownership. If you permanently store CO2 in the pore space it is now unusable for anything else so the individual who owned that pore space should be compensated for that change in the value of their property.

Chairman K. Koppelman: You said earlier that it could go two miles benefit the surface; is that typical?

Lynn Helms: Yes that is the normal. Yes, for CO2 storage it is about 1 ½ miles.

Chairman K. Koppelman: You also said water under the surface belongs to the state. What about people who drill a well?

Lynn Helms: People who drill a well have to get a permit from the state to use that water. The water belongs to the state of ND.

Chairman K. Koppelman: Are people typically charged by the gallon?

Lynn Helms: My understanding is the surface owners just pay a permit fee. People who place waste water into the pores or extract it for industrial purposes are usually charged a per gallon or per barrel fee.

Rep. Jones: We talked about putting in waste products, but the one that is coming on everyone's radar screen is we are considering pushing gas down there for temporary storage maybe to pull it out later. How is that different for temporary purposes?

Lynn Helms: Since it is temporary and the gas bubble residues there as long as the gas bubble stays inside this industrial commission spacing unit we think compensation should only be made for the surface disruption of the compressor and well etc. If the gas bubble would be large enough that impacted several surface owners; then that pore space should be compensated based on how many acres of pore space, they own. Then you need a contractual to compensate everybody.

Rep. Jones: The compensation would probably not be the same. What type of formula do you use?

Lynn Helms: That will be proposed by the operator who plans to do the project, but we have met with them and the compensation is figured out with the neighbors and surface owner. There is an open house in Richardton Wednesday night for the first CO2 storage unit. It will be Red Trail Energy.

Rep. Jones: The bill before us would be problematic because if you were going to impact somebody in that process they would shut the whole thing down because it goes back to the mandatory stuff. What is your thoughts on that?

Lynn Helms: We oppose the bill because it incorrectly connects the dots between the Industrial Commissions police over these contracts and eminent domain. Were you to pass the bill and put it up to a vote of the people and was voted down; would in effect connect those dots, but in a very negative way. Forced pooling is eminent domain and it should not be connected with that. That would unravel everything we have done since 1953. It makes a connection that doesn't exist and puts it on the statewide ballot and should the vote go one way or another; now it does become eminent domain and it should not be connected.

Rep. McWilliams: Where does the line between surface rights and minerals rights start?

Lynn Helms: It goes from the air space over your house all the way to the center of the earth so there is no depth severance. The surface owner owners the solid material and all cavities in it from the top of the soil to the center of the earth.

Rep. McWilliams: Is there a depth for mineral rights?

Lynn Helms: No. Often there are depth severances in mineral rights where one operator or mineral owner owns the mineral to a contracted depth and a different one owns them from there on down. That often impacts how we set up a spacing unit.

Rep. Jones: There are times when people have signed a lease for oil and gas so it can be explored and there have been a few individuals that have held out and not signed the lease. In that case you protect those people? They still get compensated when that is pulled out?

Lynn Helms: The attachment shows how this is laid out.

Rep. Paur: Eminent domain cannot be used on minerals?

Lynn Helms: I agree. We do not exercise eminent domain and cannot.

Chairman K. Koppelman: That is the danger in the resolution; it would be bringing minerals into the whole eminent domain into the situation and it could unravel all the laws we have passed.

Rep. Magrum: Is gravel and scoria considered minerals?

Lynn Helms: Sand and gravel are not. Anything used for aggregate is not considered a mineral or regulated under the industrial commission.

Do Not Pass Motion Made by Rep. Vetter; Seconded by Rep. Jones

Discussion:

Roll Call Vote: 13 Yes 0 No 1 Absent Carrier: Rep. Jones

Closed.

Date: 3-4-19
Roll Call Vote #: 1

2019 HOUSE STANDING COMMITTEE
ROLL CALL VOTES 3013

House **Judiciary** Committee

☐ Subcommittee

Amendment LC# or Description: _____

Recommendation: ☐ Adopt Amendment
☐ Do Pass ☑ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions: ☐ Reconsider ☐ _____

Motion Made By Vetter Seconded By Jones

Representatives	Yes	No	Representatives	Yes	No
Chairman Koppelman	✓		Rep. Buffalo	✓	
Vice Chairman Karls	✓		Rep. Karla Rose Hanson	✓	
Rep. Becker	✓				
Rep. Terry Jones	✓				
Rep. Magrum	✓				
Rep. McWilliams	✓				
Rep. B. Paulson	✓				
Rep. Paur	✓				
Rep. Roers Jones	✓				
Rep. Satrom	✓				
Rep. Simons	—				
Rep. Vetter	✓				

Total (Yes) 13 No 0

Absent 1

Floor Assignment Rep. Jones

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HCR 3013: Judiciary Committee (Rep. K. Koppelman, Chairman) recommends **DO NOT PASS** (13 YEAS, 0 NAYS, 1 ABSENT AND NOT VOTING). HCR 3013 was placed on the Eleventh order on the calendar.

2019 TESTIMONY

HCR 3013

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P. 1

Chairman Koppelman and members of the House Judiciary Committee.

I am Representative Marvin Nelson of District 9.

HCR3013 is a Constitutional amendment to allow forced pooling of minerals and poor space. Forced pooling is the taking of private property, most commonly oil or natural gas, and allowing other private industry to extract it.

The issue is not really compensation and I'm not going to talk about that because the issue isn't if the owner is fairly compensated, it is that his property is taken, with or without his permission and used by others.

Let's take a simple example, 80 acre pool spacing, two owners who each own half, one wants to drill, one doesn't. The one who wants to drill goes to the Industrial Commission and they issue and order allowing the drilling. The wishes of the one owner doesn't matter, his oil and gas is taken.

There is also the version of the mega units where even the leases the owners have previously signed don't really matter but I'm not going to get into that.

In any case, this has been a national fight and courts have generally ruled that it is Constitutional, the difference is, the North Dakota Constitution.

If you remember back in 2005 the US Supreme Court ruled that private property could be taken through eminent domain for private business. See Kelo v. City of New London. That very thing happened in ND where a city took a grocery store from an individual and gave the property to a different owner to build a grocery store. The basis being it was a new nicer, bigger store and that meant economic development.

Well the people of ND reacted, the result being Measure 2 in 2006 which amended the ND Constitution. 67.49% voting yes.

It amended Article 1 Section 16 of the ND Constitution. I provide the entire section with the part added underlined.

Section 16. Private property shall not be taken or damaged for public use without just compensation having been first made to, or paid into court for the owner, unless the owner chooses to accept annual payments as may be provided for by law. No right of way shall be appropriated to the use of any corporation until full compensation therefor be first made in money or ascertained and paid into court for the owner, unless the owner chooses annual payments as may be provided by law, irrespective of any benefit from any improvement proposed by such corporation. Compensation shall be ascertained by a jury, unless a jury be waived. When the state or any of its departments, agencies or political subdivisions seeks to acquire

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right of way, it may take possession upon making an offer to purchase and by depositing the amount of such offer with the clerk of the district court of the county wherein the right of way is located. The clerk shall immediately notify the owner of such deposit. The owner may thereupon appeal to the court in the manner provided by law, and may have a jury trial, unless a jury be waived, to determine the damages, which damages the owner may choose to accept in annual payments as may be provided for by law. Annual payments shall not be subject to escalator clauses but may be supplemented by interest earned.

For purposes of this section, a public use or a public purpose does not include public benefits of economic development, including an increase in tax base, tax revenues, employment, or general economic health. Private property shall not be taken for the use of, or ownership by, any private individual or entity, unless that property is necessary for conducting a common carrier or utility business.

As you can see a very tight prohibition of private eminent domain. Only to be used for utilities and common carriers and you cannot even use the argument of increased taxes or economic development. Pretty clearly forced pooling violates that prohibition, the process might be different than we are used to calling eminent domain but it is still private eminent domain.

Now there are very good reasons it should be allowed in mineral development. For instance a small owner might block the economic use by a large number of owners of their property. We might not even be able to find that small owner.

In the case of pore space we have by law said it cannot be severed from the surface an there we can find the owners, but pore space really does act much more like the theoretical pool than oil does. There is a need to be able to pool pore space for say carbon dioxide storage or natural gas storage. The mineral owner has a dominant right over the surface owner within a spacing unit, but not if what is being injected is in a different spacing unit.

In any case, I am recommending passing and putting to the voters the Constitutional amendment at the least remove any question about forced pooling being Constitutional in ND.

Compulsory pooling has been adopted by many states to protect landowner/mineral owner rights and promote the efficient extraction of natural resources.[i] Compulsory pooling orders also serve to protect the right of landowners/mineral owners to exploit their own mineral rights even when their interest is insufficient to allow for extraction under state law or when there is one holdout interest owner among many consenting interest owners.[ii] Without compulsory pooling orders, the owner of an oil and gas interest on the opposite side of a not consenting owner could be blocked from developing their mineral interests.[iii] The blocked owner may not be able to exercise their right to develop their mineral interests and would not receive any compensation for the loss of their right to develop their minerals interests or receive royalties.

"The constitutionality of legislation regulating the production, use, storage and transportation of oil has been supported on one or more of three basic legal theories that it is within the police power of the state a) to enact and enforce legislation to protect the correlative rights of owners of land within a common source of supply of oil and gas; (b) to safeguard the public interest in oil and gas as natural resources, and (c) to prevent or abate surface nuisances resulting from the operation on land for oil and gas purposes." [iv] "[A] state has [the] constitutional power to regulate production of oil and gas so as to prevent waste and to secure equitable apportionment among landholders of the migratory gas and oil underlying their land, fairly distributing among them the costs of production and of the apportionment."[v]

In order to reduce waste and inefficiency, the North Dakota legislature enacted an Act for the Control of Gas and Oil Resources in 1953.[vi]

While property rights are protected by the North Dakota Constitution, property rights are not absolute.[vii] The North Dakota Supreme Court has recognized compulsory pooling and unitization as constitutional and that Industrial Commission orders for spacing or pooling are a valid use of the State's police powers.[viii] This Court has previously rejected a claim that a properly issued Commission order can constitute a taking of private property

under Article I, Section 16 of the North Dakota Constitution and, thus, has held that the exercise of the Commission's police powers supersedes a property interest owner's right to use his oil and gas properties as he pleases.[ix] Under the State's police powers, the state may impose restrictions upon private rights necessary for the general welfare of all.[x] The State's exercise of its police powers, prevents one interest owner (whether it be a lease holder or unleased mineral interest owner) from blocking others from utilizing their mineral interests or from taking the migratory gas and oil underlying their land.

The 2007 amendment to Art. I, § 16 of the North Dakota Constitution limited the states use of eminent domain, it did not place a limit on the state's police powers. As the Court has already rejected the claim that the Industrial Commission ordering pooling or unitization are a private taking, the amendment would not have any bearing on the state exercising its police power to protect the general welfare of all in the production of oil and gas.[xi]

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[i] http://www.ncsl.org/research/energy/compulsory-pooling-laws-protecting-the-conflicting-rights-of-neighboring-landowners.aspx#id. At least 32 states have some form of compulsory pooling.
[ii] Id.
[iii] Id.
[iv] Summers Oil and Gas 3rd Edition §4.39
[v] Hunter c. v. McHugh, 320 U.S. 222, 227 (1943).
[vi] Continental Resources, Inc. v. Farrar Oil Co. 1997 ND 31, ¶ 12; 559 N.W.2d 841 (1997)
[vii] Id. at ¶ 15, (citing N.D.Const., art. I, § 1; N.D.Const., art. I, § 16; and N.D.Const., art. XII, § 5).
[viii] Continental Resources, Inc. v. Farrar Oil Co. 1997 ND 31 ¶16, 559 N.W.2d 841 (1997), (citing Slawson v. North Dakota Indus. Comm's, 339 N.W.2d 772 (N.D. 1983); Hystad v. Industrial Comm'n, 389 N.W.2d 590, 594 (N.D. 1986) and Texaco Inc. V. Industrial Comm'n, 448 N.W.2d 621, 624 (N.D.1989)).
[ix] Id.
[x] Id. at ¶15.
[xi] See id. at ¶16.

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38-08-07. COMMISSION SHALL SET SPACING UNITS. The commission shall set spacing units as follows:

1. When necessary to prevent waste, to avoid the drilling of unnecessary wells, or to protect correlative rights, the commission shall establish spacing units for a pool. Spacing units when established must be of uniform size and shape for the entire pool, except that when found to be necessary for any of the purposes above mentioned, the commission is authorized to divide any pool into zones and establish spacing units for each zone, which units may differ in size and shape from those established in any other zone.

2. The size and shape of spacing units are to be such as will result in the efficient and economical development of the pool as a whole.

3. An order establishing spacing units for a pool must specify the size and shape of each unit and the location of the permitted well thereon in accordance with a reasonably uniform spacing plan. Upon application, if the commission finds that a well drilled at the prescribed location would not produce in paying quantities, that surface conditions would substantially add to the burden or hazard of drilling such well, or that the drilling of such well at a location other than the prescribed location is otherwise necessary either to protect correlative rights, to prevent waste, or to effect greater ultimate recovery of oil and gas, the commission is authorized to enter an order permitting the well to be drilled at a location other than that prescribed by such spacing order; however, the commission shall include in the order suitable provisions to prevent the production from the spacing unit of more than its just and equitable share of the oil and gas in the pool.

4. An order establishing units for a pool must cover all lands determined or believed to be underlaid by such pool, and may be modified by the commission from time to time to include additional areas determined to be underlaid by such pool. When found necessary for the prevention of waste, or to avoid the drilling of unnecessary wells, or to protect correlative rights, an order establishing spacing units in a pool may be modified by the commission to increase or decrease the size of spacing units in the pool or any zone thereof, or to permit the drilling of additional wells on a reasonably uniform plan in the pool, or any zone thereof, or an additional well on any spacing unit thereof.

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Wellbore Schematic

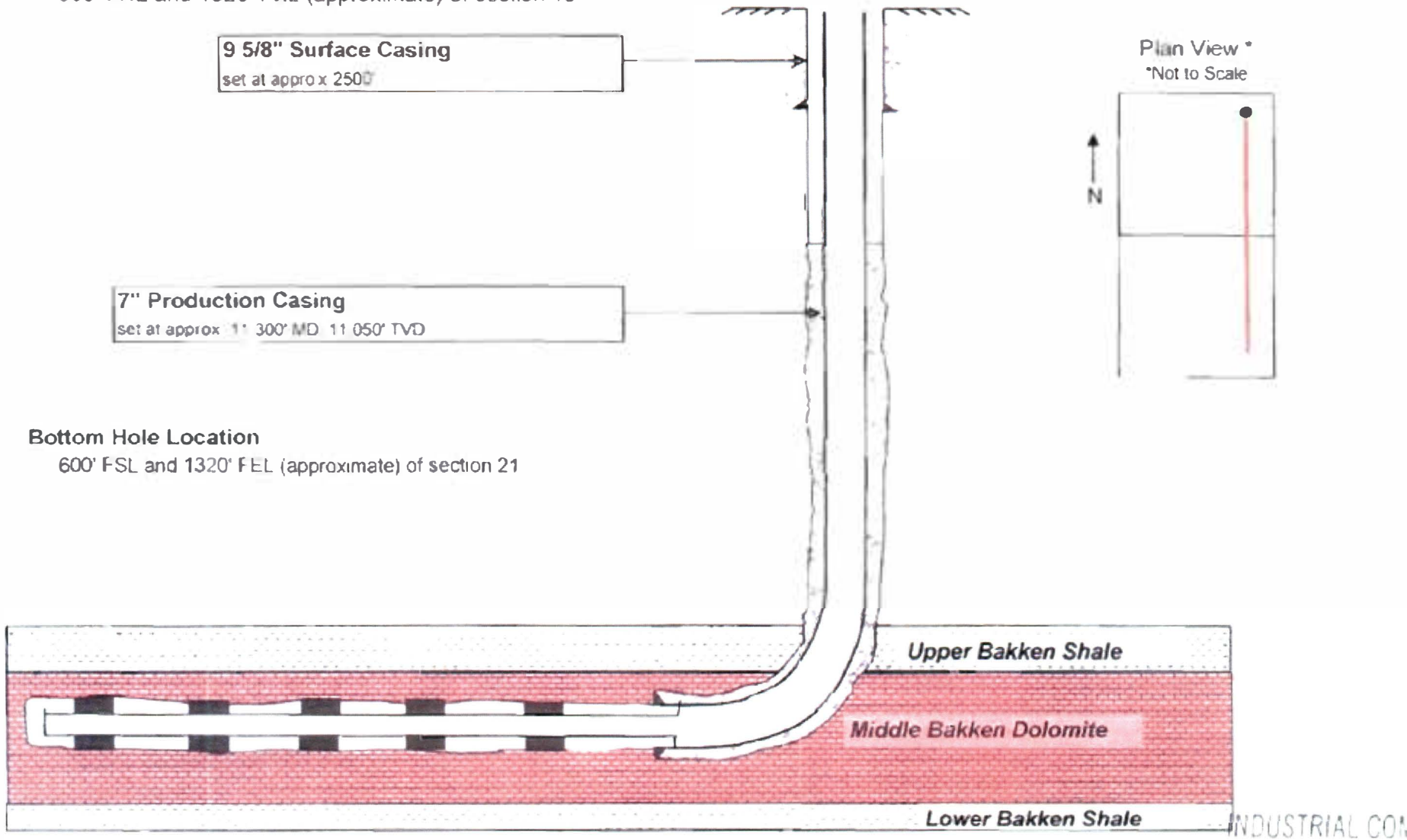
Sec's 16 & 21, T148N, R95W
Dunn County, ND

Surface Location
300' FNL and 1320' FEL (approximate) of section 16

9 5/8" Surface Casing
set at approx 2500'

7" Production Casing
set at approx 11,300' MD, 11,050' TVD

Bottom Hole Location
600' FSL and 1320' FEL (approximate) of section 21



Plan View *
*Not to Scale

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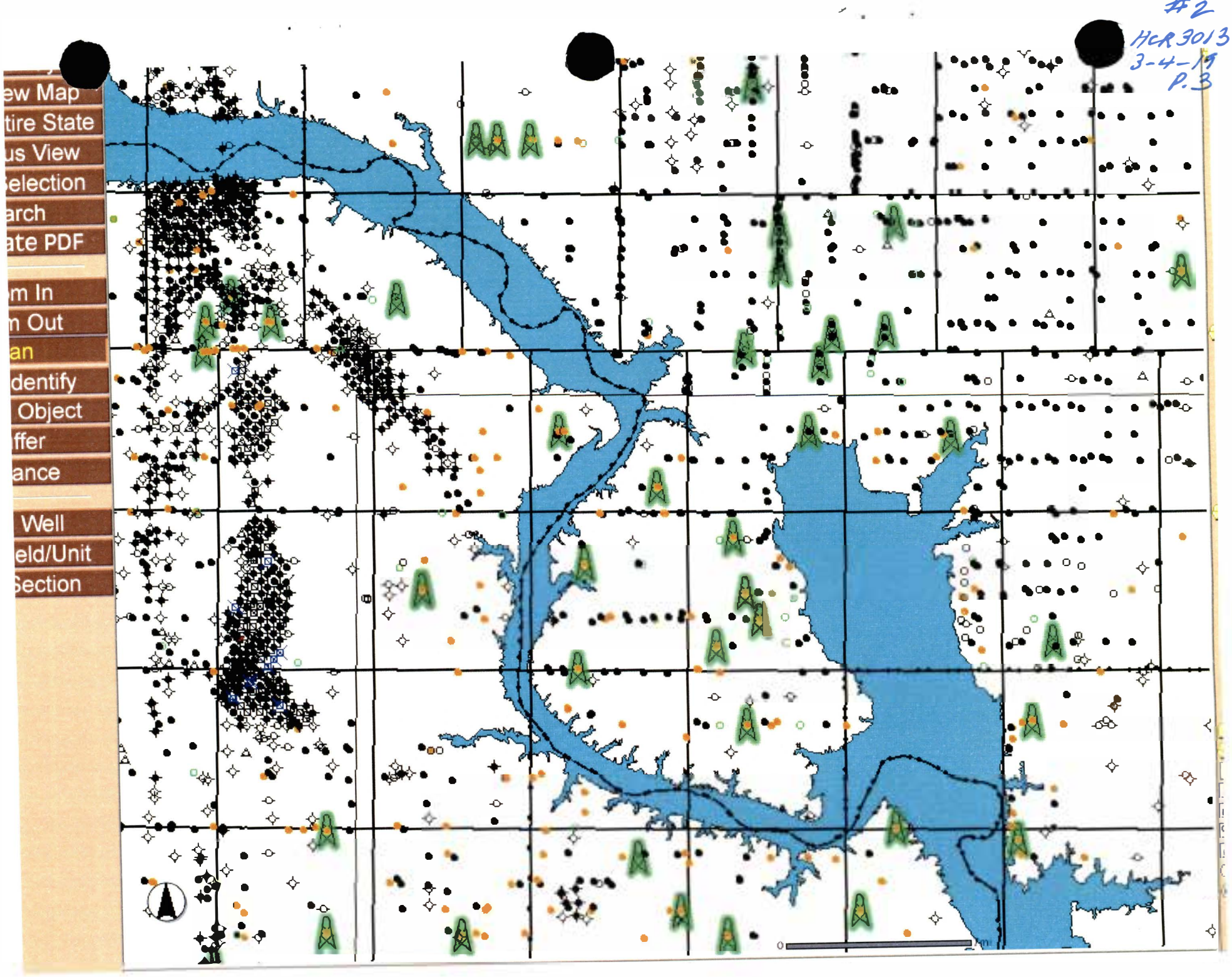

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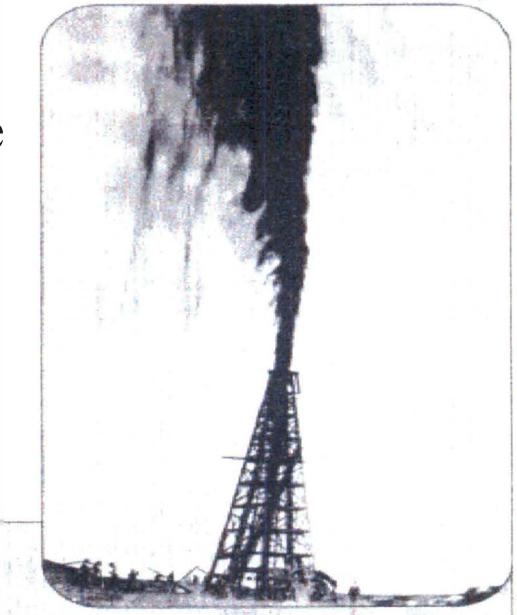
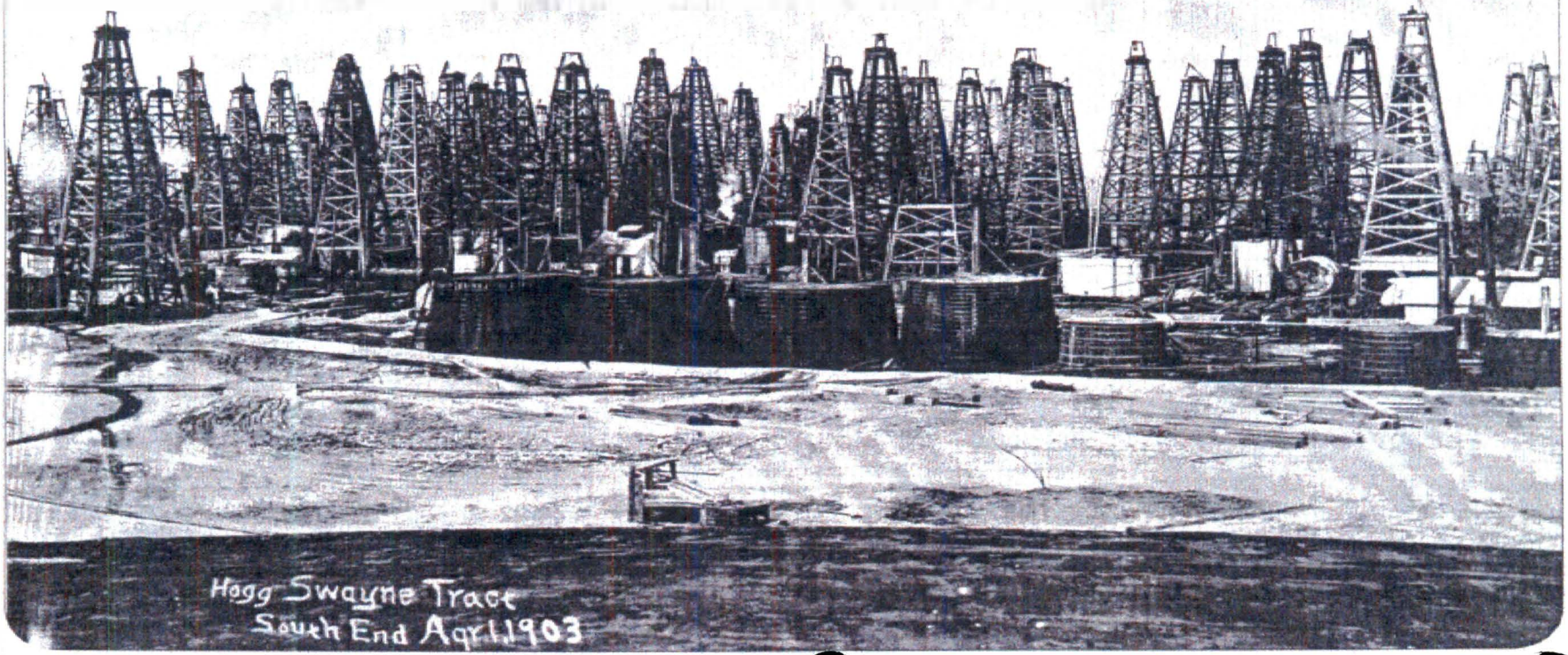
100 years ago wells were drilled wherever they would fit (rule of capture), and were not spaced on the basis of geology and engineering as is currently done by the North Dakota Industrial Commission.

This wasted a great deal of the oil and gas.



Developers swarmed the Beaumont area after the Lucas discovery in 1901 (top right). This forest of rigs was part of a Hogg-Swayne Syndicate tract in 1903.



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Vern Whitten Photography

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38-08-08. INTEGRATION OF FRACTIONAL TRACTS.

1. When two or more separately owned tracts are embraced within a spacing unit, or when there are separately owned interests in all or a part of the spacing unit, then the owners and royalty owners thereof may pool their interests for the development and operation of the spacing unit. In the absence of voluntary pooling, the commission upon the application of any interested person shall enter an order pooling all interests in the spacing unit for the development and operations thereof. Each such pooling order must be made after notice and hearing, and must be upon terms and conditions that are just and reasonable, and that afford to the owner of each tract or interest in the spacing unit the opportunity to recover or receive, without unnecessary expense, his just and equitable share. Operations incident to the drilling of a well upon any portion of a spacing unit covered by a pooling order must be deemed, for all purposes, the conduct of such operations upon each separately owned tract in the drilling unit by the several owners thereof. That portion of the production allocated to each tract included in a spacing unit covered by a pooling order must, when produced, be deemed for all purposes to have been produced from such tract by a well drilled thereon. For the purposes of this section and section 38-08-10, any unleased mineral interest pooled by virtue of this section before August 1, 2009, is entitled to a cost-free royalty interest equal to the acreage weighted average royalty interest of the leased tracts within the spacing unit, but in no event may the royalty interest of an unleased tract be less than a one-eighth interest. An unleased mineral interest pooled after July 31, 2009, is entitled to a cost-free royalty interest equal to the acreage weighted average royalty interest of the leased tracts within the spacing unit or, at the operator's election, a cost-free royalty interest of sixteen percent. The remainder of the unleased interest must be treated as a lessee or cost-bearing interest.

2. Each such pooling order must make provision for the drilling and operation of a well on the spacing unit, and for the payment of the reasonable actual cost thereof by the owners of interests in the spacing unit, plus a reasonable charge for supervision. In the event of any dispute as to such costs the commission shall determine the proper costs. If one or more of the owners shall drill and operate, or pay the expenses of drilling and operating the well for the benefit of others, then, the owner or owners so drilling or operating shall, upon complying with the terms of section 38-08-10, have a lien on the share of production from the spacing unit accruing to the interest of each of the other owners for the payment of his proportionate share of such expenses. All the oil and gas subject to the lien must be marketed and sold and the proceeds applied in payment of the expenses secured by such lien as provided for in section 38-08-10.

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38-08-08. INTEGRATION OF FRACTIONAL TRACTS.

3. In addition to any costs and charges recoverable under subsections 1 and 2, if the owner of an interest in a spacing unit elects not to participate in the risk and cost of drilling a well thereon, the owner paying for the nonparticipating owner's share of the drilling and operation of a well may recover from the nonparticipating owner a risk penalty for the risk involved in drilling the well. The recovery of a risk penalty is as follows:

a. If the nonparticipating owner's interest in the spacing unit is derived from a lease or other contract for development, the risk penalty is two hundred percent of the nonparticipating owner's share of the reasonable actual costs of drilling and completing the well and may be recovered out of, and only out of, production from the pooled spacing unit, as provided by section 38-08-10, exclusive of any royalty or overriding royalty.

b. If the nonparticipating owner's interest in the spacing unit is not subject to a lease or other contract for development, the risk penalty is fifty percent of the nonparticipating owner's share of the reasonable actual costs of drilling and completing the well and may be recovered out of production from the pooled spacing unit, as provided by section 38-08-10, exclusive of any royalty provided for in subsection 1.

c. The owner paying for the nonparticipating owner's share of the drilling and operation of a well may recover from the nonparticipating owner a risk penalty for the risk involved in drilling and completing the well only if the paying owner has made an unsuccessful, good-faith attempt to have the unleased nonparticipating owner execute a lease or to have the leased nonparticipating owner join in and participate in the risk and cost of drilling the well. Before a risk penalty may be imposed, the paying owner must notify the nonparticipating owner with proof of service that the paying owner intends to impose a risk penalty and that the nonparticipating owner may object to the risk penalty by either responding in opposition to the petition for a risk penalty or if no such petition has been filed, by filing an application or request for hearing with the industrial commission.

NATIONAL CONFERENCE of STATE LEGISLATURES

Compulsory Pooling Laws: Protecting the Conflicting Rights of Neighboring Landowners

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What Is Compulsory Pooling?

Compulsory pooling, also known as forced, statutory or mandatory pooling, forces landowners—who do not wish the mineral resources underneath their land to be extracted—to become part of a drilling unit. Although this process does not allow extraction companies surface access to the non-consenting landowner's property, it does allow drilling to occur underneath their land, while compensating the owner for the extracted resource.

Solving Resource Disputes: Drilling Unitization and Pooling

Unitization and compulsory pooling laws are a response to state attempts to limit the number of oil and gas wells that may be drilled in an area to capture mineral resources. Historically, landowners and mineral extraction companies could drill as many wells on a parcel of land as they wished. Because the "rule of capture" governed natural resources, the first person or company to extract a mineral resource was entitled to collect exclusive profits on that resource. This meant that neighboring landowners often raced one another to extract the most oil or natural gas from a common pool underlying two properties, since the first to extract the resource was entitled to the profits. This practice also meant that, at times, landowners with mineral resources beneath the surface of their land had their share of the resource extracted by a neighboring landowner without compensation.

In order to prevent over-drilling, limit the number of wellheads on a parcel of land and protect the sub-surface mineral rights of neighboring landowners, many states have adopted minimum ownership requirements, mandating that oil and gas operators have control over a minimum amount of land before they can begin drilling operations. These mandatory unitization laws require the pooling of mineral interests into a drilling unit by the extraction company before resource extraction may occur (Figure 1). Mineral interests are "pooled" when extraction companies purchase or lease mineral rights from multiple landowners until the extraction companies own the rights to enough land to start drilling operations. Unitization laws are mandatory but do not force landowners who do not wish to extract minerals from their land to participate in the process. Rather, they require oil companies and consenting landowners to limit the amount of wells they drill.

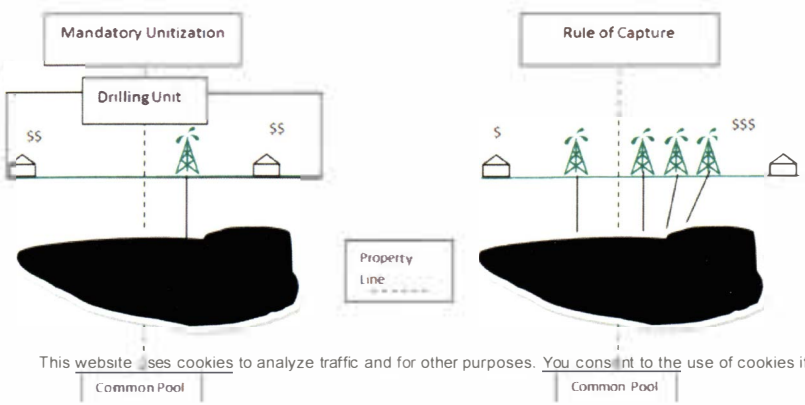
Understanding the Lingo

Rule of Capture: The "rule of capture" originated in the early laws governing ownership rights of wild animals. According to these rules, the first person to bring a wild animal under their control by capturing, killing or mortally wounding the animal acquired ownership rights of that animal. Later, this rule was applied to the "capture" of natural resources. Sub-surface mineral rights in the U.S. generally belong to the owner of the surface land. When a common pool of oil or gas lies under the property of two or more neighboring landowners, the rule of capture applies unless it has been superseded by state statutes Accordingly, the first person to gain control over the resource (by extracting the resource from the ground) gains exclusive ownership over that resource. Pooling and unitization laws replace this common law tradition, thereby protecting the rights of landowners who are not the first to drill.

Drilling Unit: A "drilling unit" is a parcel of land of a specified size and shape upon which one well may be drilled into an underground pool or reservoir.

Pooling: During the pooling process, extraction companies purchase or lease mineral rights from multiple landowners and 'pool' them to form a drilling unit upon which they can legally place a drill rig.

Figure 1: Mandatory unitization versus the rule of capture



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When Does Compulsory Pooling Occur?

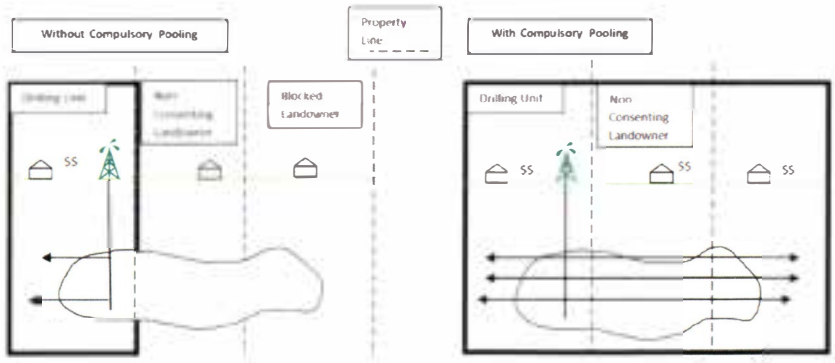
Compulsory pooling occurs most often in areas with high levels of hydraulic fracturing. In such circumstances, often o landowner, (Farmer A) is approached by an extraction company and asked to lease or sell his mineral rights. If Farme agrees, the extraction company will likely still need to obtain the mineral rights of his neighbors in order to form a drilling unit big enough to drill a wellhead. Now, let's say Farmer C wants to similarly lease his land. Farmer B, however, is worried about the effects of extraction on his land and does not want to lease his mineral rights to the extraction company. In cases where Farmer B's land is positioned so that, in order for the extraction company to include Farmer C and other landowners in the drilling unit, they must have access underneath Farmer B's land, Farmer B's land may be forcibly included in the drilling unit by the state.

How States Address Compulsory Pooling

Many states have adopted laws—in addition to mandatory unitization laws—to govern circumstances in which neighboring landowners disagree about whether or not to extract mineral resources from common pools underneath their land. Where, in certain circumstances, one adjoining landowner does not consent to a voluntary pooling agreement (unitization), compulsory pooling laws allow resources to be extracted from underneath the non-consenting landowner's property by requiring this landowner to become part of a drilling unit. The non-consenting landowner is typically offered a chance to either participate in the voluntary pooling agreement or is granted a statutorily-specified compensation package. Landowners who do not ultimately consent to participate in a voluntarily pooling agreement retain all rights to surface access to their land—mining operations subject to a compulsory pooling order may only access a non-consenting landowners land under the surface (Figure 2).

States have adopted mandatory pooling laws to attempt to protect landowner rights and promote the efficient extraction of natural resources. Without compulsory pooling laws, state governments miss out on revenues from state severance and income taxes, and, because a portion of the oil or gas resource cannot be developed, the remainder of the land cannot be drilled in the most efficient manner. Compulsory pooling orders also serve as anti-holdout laws, protecting t right of landowners to exploit their own mineral rights even where their own land is of insufficient acreage to allow for extraction under state law. This is particularly relevant where there is one holdout landowner among many consenting owners. The increase in the use of horizontal fracturing has made mandatory pooling laws particularly relevant. Without a mandatory pooling order, the owner of oil and gas on the opposite side of a non-consenting gas owner could be "blocked" so that the horizontal arms of the main hydraulic fracturing well could not reach this property. Mandatory pooling laws, however, have been controversial. Many view the forced-extraction of mineral resources as an issue of eminent domain and question the fairness of cost and risk sharing mechanisms. Despite this criticism, courts have consistently found mandatory pooling laws to be constitutional.

Figure 2: Comparing Properties With and Without Compulsory Pooling



In many states—including Kentucky, Ohio and Virginia—compulsory pooling orders may only be made once a certain percentage of landowners in a proposed unit have signed drilling agreements. This percentage varies among states, with

Ohio's law requiring the consent of 90 percent of landowners and Virginia's law requiring only 25 percent before other landowners may be obliged to enter into the mandatory pool.

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Almost all major oil and gas producing states—with the exceptions of California and Kansas—have adopted some kind of mandatory/compulsory pooling scheme. Landowners subject to a mandatory pooling order are generally compensated for their mineral resources according to each state's compulsory pooling statute. In most states, non-consenting landowners must either pay an up-front cost to compensate the drilling company for bearing the costs and risks of production, or must pay these costs out of their share of the mineral profits. These statutory schemes generally reflect one of the following three approaches to compensation for non-consenting landowners:

"Costs-Only" Approach

(Alaska, Arizona, Indiana and Missouri)

Under "costs-only" statutory schemes, the non-consenting owner is held liable for production costs only if the extraction is successful, without bearing any of the risks associated with extraction. This approach heavily favors the non-consenting landowner, but also has the effect of discouraging voluntary pooling agreements by creating favorable conditions for hold-out landowners. It may also discourage production by forcing extraction companies to bear all of the risk of drilling, including the possibility that the well comes up dry.

- In Alaska, non-consenting landowners may be charged only for the costs of production attributable to their proportionate share in the event that the drilling is successful. No additional risk-penalty is assessed for landowners who do not choose to participate in drilling. Alaska's scheme is also unique in that it allows landowners to drill on their individual parcels in the event that a voluntary pooling agreement cannot be reached and the conditions are not met for a compulsory pooling order. In this case, a landowner would be allowed to extract only an amount of oil or gas proportionate to their share of the overall drilling area.

"Risk-Penalty" Approach

(The most common approach—used by most major oil and gas producing states, including Alabama, Colorado, North Dakota, and Texas)

Under this approach, a non-consenting owner is subject to a "risk penalty" to reward the extraction company for bearing the risks associated with drilling. This penalty is effective where the extraction is successful and is generally calculated as a pre-determined percentage of the landowner's compensation. The risk-penalty approach is thought to encourage voluntary pooling agreements by landowners who want to avoid paying a risk-penalty—which can sometimes be as high as 300 percent of the reasonable costs of production. However, it has been criticized as being too favorable to extraction companies. This approach represents the most common statutory scheme among major oil and gas producing states.

- Colorado uses a risk-penalty approach, wherein any non-consenting landowner must pay for 100 percent of his share of equipment and operating costs for the well as well as 200 percent of his share of costs incurred in well exploration (this is the risk penalty).

"Options Given" Approach

(Pennsylvania, Virginia and West Virginia)

Under this approach, non-consenting owners can choose an alternative from a list of options that best fits their own specific circumstances upon receiving a mandatory pooling order. Generally, such schemes include an automatic option that is triggered if the non-consenting landowner does not make a timely election. Advocates of this option stress that giving landowners options best reflects the actual marketplace by allowing landowners to choose the option that most benefits them. However, this scheme also discourages voluntary pooling by encouraging landowners to adopt a "wait and see" approach by which they may choose a more favorable option under the mandatory pooling order.

- For example, in West Virginia, non-consenting landowners may either: 1) sell their mineral interests to participating landowners for just consideration or 2) elect to participate on a limited basis (without sharing full costs) on terms to be determined by the board entering the order. These terms may or may not include the payment of a risk-penalty.

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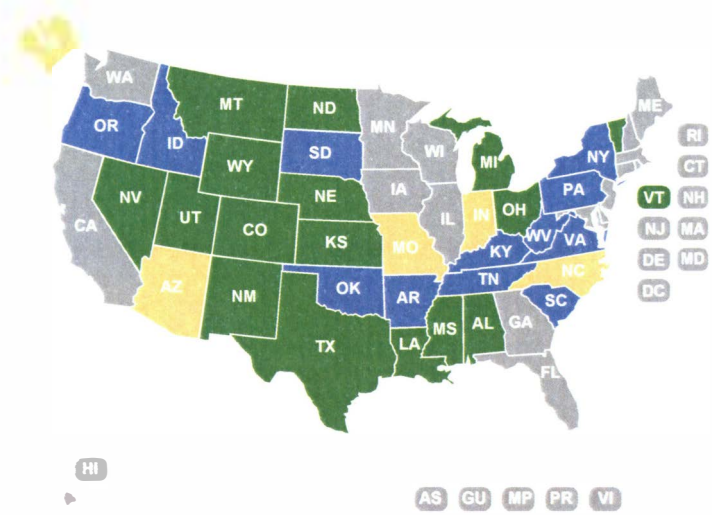
The following map and chart details current state compulsory pooling laws. At least 34 states have laws permitting forced pooling. Some additional states, like Florida, have laws governing pooling and unitization but do not have compulsory pooling laws currently in effect.

COMPULSORY POOLING LAWS

Cost Only States | Risk-Penalty States | Enumerated Options States | States With No Compulsory Pooling Laws



State	Statutory Provision	Type	Description
Alabama	Ala. Code § 9-17-13	Risk-Penalty Approach	Alabama uses a risk-penalty approach, wherein any non-consenting landowner who does not agree to pay a prospective proportionate share of drilling and completion costs is subject to a risk penalty of 150 percent of the tract's share of the reasonable costs of drilling and production.
Alaska	Alaska Stat. § 31.05.100	Costs-Only Approach	Alaska uses a free-ride approach, by which non-consenting landowners may be charged for the costs of production attributable to their proportionate share only in the event that the drilling is successful. Alaska's scheme is also unique in that it allows landowners to drill on their individual parcels in the event that a voluntary pooling agreement cannot be reached and the conditions are not met for a compulsory pooling order. In this case, such a landowner would be allowed to extract only an amount of oil or gas proportionate to their share of the overall drilling area.
American Samoa	*NO Compulsory Pooling Laws*		
Arizona	Ariz. Rev. Stat. Ann. § 27-505	Costs-Only Approach	Arizona uses a free-ride approach, by which non-consenting landowners may be charged for the costs of production attributable to their proportionate share only in the event that the drilling is successful. This scheme is also unique in that it allows landowners to drill on their individual parcels in the event that a voluntary pooling agreement cannot be reached and the conditions are not met for a compulsory pooling order. In this case, such a landowner

	would be allowed to extract only an amount of oil or gas proportionate to their share of the overall drilling area.		
Arkansas	Ark. Stat. Ann. § 15-72-304	Options-Given Approach	Non-consenting owners in Arkansas may either sell their interests in the unit to a participating landowner, lease their mineral interests to a member of the unit, or voluntarily pay for the costs of production as a working interest owner (become a consenting landowner).
California	*NO compulsory pooling law*		
Colorado	Colo. Rev.Stat. § 34-60-116	Risk-Penalty Approach	Colorado uses a risk-penalty approach, wherein any non-consenting landowner must pay for 100 percent of his share of equipment and operating costs for the well as well as 200 percent of his share of costs incurred in well exploration (this is the risk penalty). The Colorado scheme allows these costs to either be paid to participating landowners upfront, at which point the landowner receives dividends as if he had been a consenting owner from the start, or, to pay for these costs through a calculated royalty system.
Connecticut	*NO compulsory pooling law*		
Delaware	*NO compulsory pooling law*		
District of Columbia	*NO compulsory pooling law*		
Florida	*NO compulsory pooling law*		Florida has statutory rules regarding voluntary pooling and unitization; however, there is no forced or compulsory pooling law in the state. (Fla. Stat. § 377.28)
Georgia	*NO compulsory pooling law*		
Guam	*NO compulsory pooling law*		
Hawaii	*NO compulsory pooling law*		
Idaho	Idaho Code § 47-322	Options-Given Approach	Idaho law provides that a landowner whose land is subject to a mandatory pooling order (an order of commission according to the statute) may either: 1) Choose to participate in the costs and risks of production or 2) Choose to sell his leasehold interest to the participating owners for just compensation.
Illinois	*NO compulsory pooling law*		
Indiana		Costs-Only Approach	

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	Ind. Code § 14-37-9-2; Ind. Code § 14-37-9-3		If an integration order is entered, the operator may charge each interested owner only for the actual reasonable expenditures required for the development of the resource.
Iowa	*NO compulsory pooling law*		
Kansas	Kan. Rev. Stat. § 55-1305	Risk-Penalty Approach	Kansas has strict requirements that must be met before a compulsory pooling order will take effect; however, once granted, the non-consenting landowner may be required to pay up to 100 percent of his share of the aboveground drilling costs and 300 percent of his share of the physical drilling and underground pipeline costs.
Kentucky	Ky. Rev. Stat. § 349.085	Options-Given Approach	Kentucky's compulsory pooling laws pertain primarily to coal bed methane gas pools. Non-consenting owners have the option to either sell or lease their mineral interest to a participating owner OR share in the proceeds from the pool minus 200 percent of his share of the total production costs.
Louisiana	La. Rev. Stat. Ann. 30:10	Risk-Penalty Approach	
Maine	NO compulsory pooling law		
Maryland	NO compulsory pooling law		
Massachusetts	NO compulsory pooling law		
Michigan	Mich. Comp. Laws Ann. § 324.61513	Combination Costs-Only/Risk-Penalty	Michigan's compulsory pooling law gives a non-consenting owner a cost-free royalty equal to 1/8 of their interest. The remaining 7/8 interest is subject to a risk-penalty amounting to 100-300 percent of his share of the costs of development.
Minnesota	Minn. Stat. § 93.515		Minnesota's statutory guidelines do not specifically allow for mandatory pooling; however, the statute indicates that such rules "may" be adopted by the state commissioner of natural resources.
Mississippi	Miss. Code Ann. § 53-3-7	Risk-Penalty Approach	Non-consenting owners in Mississippi are required to pay, from their share of profits from the well, 100 percent of their share of any new surface equipment, 250 percent of their share of the reasonable costs as provided in the pooling order, 250 percent of their share of any new subsurface well equipment, and 100 percent of their share of the cost of operation of the well commencing with first production.
Missouri	Mo. Rev. Stat. § 259.110	Costs-Only Approach	The non-consenting owner's share of the production costs are carried by the operator and the owner is only responsible for the proportionate share of the costs of drilling if the well is successful.
Montana			

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	Mont. Code Ann. § 82-11-202	Risk-Penalty Approach	A non-consenting landowner in Montana may be required to pay up to 100 percent of his share of the costs of the operation of the well, plus 100 percent of his share of any equipment acquired to drill and operate the well, plus up to 200 percent of the costs of staking and well-site preparation.
Nebraska	Neb. Rev. Stat. § 57-909	Risk-Penalty Approach	The Nebraska statute describes a complicated risk-penalty scheme that calculates the risk-penalty owed by non-consenting owners according to the depth of the well at issue. Non-consenting owners, under the Nebraska scheme, may have to pay from 200-500 percent of their share of the costs of drilling and production applicable to his interest in the well.
Nevada	Nev. Rev. Stat. § 522.060	Risk-Penalty Approach	Under the Nevada compulsory pooling law, non-consenting landowners may be forced to pay a penalty of up to 300 percent of the costs of production, to be calculated based on the cost of extraction from that owner's land.
New Hampshire	*NO compulsory pooling law*		
New Jersey	*NO compulsory pooling law*		
New Mexico	N.M. Stat. Ann. § 70-2-17	Risk-Penalty Approach	New Mexico's compulsory pooling law requires non-consenting owners to pay their share of production costs, plus a risk-penalty of up to 200 percent of these costs, out of that owner's share of the profits from the drilling unit.
New York	New York Environmental Conservation Law § 23-0901	Options-Given Approach	The New York statutory scheme enumerates a list of compensation and penalty options for non-consenting landowners.
North Carolina	N.C. Gen. Stat. § 113-393	Costs-Only Approach	North Carolina currently operates as a "free ride" statute; however, the state has recently established a commission to review and recommend updates to the state's statutory scheme. No legislation is currently pending in North Carolina.
North Dakota	N.D. Cent. Code, § 38-08-08	Risk-Penalty Approach	North Dakota's statutory scheme requires a non-consenting owner to pay a risk penalty of 50-200 percent of his share of the costs of drilling; this amount varies according to whether or not the non-consenting owner agrees to lease his or her mineral rights. Owners of un-leased properties pay a greater risk-penalty.
Northern Marina Islands	*NO compulsory pooling laws*		
Ohio	Ohio Rev. Code Ann. § 1509.27	Risk-Penalty Approach	Under the Ohio scheme, the operator or owner of a well (or members of a voluntary drilling unit) who bears the costs and risks of production may deduct from a non-consenting owner's share of

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			the well's profits his share of the costs of operating the well plus a risk penalty of up to 200 percent of these costs.
Oklahoma	Okla. Stat. tit. 52, § 87.1	Options-Given Approach	Oklahomans who receive a forced pooling order may choose to either receive enumerated royalty payments from the operator of well (with no costs deducted) or may choose to participate in the operation of the well, paying operating costs up front and receiving a greater share of the well's profits.
Oregon	Or. Rev. Stat. § 520.220	Options-Given Approach	The Oregon statute stipulates that tracts of land may be integrated based on terms that are "just and reasonable" to be determined by the Department of Geology and Mineral Industries and laid out in the compulsory pooling order.
Pennsylvania	Pa. Cons. Stat. tit 58, § 408	Options-Given Approach*	Pennsylvania's statutory scheme provides for several different alternatives for non-consenting landowners, including the option to participate in the operation of the well (paying some up-front costs); the option to lease their rights to participating landowners; and the option to accept royalty payments minus the costs of production and a risk-penalty assessment.
Puerto Rico	*NO compulsory pooling laws*		
Rhode Island	*NO compulsory pooling law*		
South Carolina	S.C. Code Ann. § 48-43-340	Options-Given Approach	South Carolina's statutory scheme requires the non-consenting owner either lease his interest to participating landowners or participate in the costs and risks of production in a manner to be determined by the integration order.
South Dakota	S.D. Codified Laws § 45-9-33	Options-Given Approach	The South Dakota statute allows non-participating owners to participate in the risk and cost of the drilling or may elect to surrender his or her leasehold interest to the participating owners on some "reasonable basis and for a reasonable consideration", to be determined by the pooling order.
Tennessee	Tenn. Code Ann. § 60-1-202	Options-Given Approach	Under the Tennessee statute, a forced integration order may be entered if more than fifty percent of landowners with interests in the pool request such unitization. The board is to set just compensation mechanisms for non-consenting owners.
Texas	Tex. Natural Resources Code § 102.052	Risk-Penalty Approach	Under the Texas statute, any non-consenting owner who is subject to a compulsory pooling order who elects not to pay a proportionate share of the operating costs and risks of production will be subject to a risk-penalty fee of up to 100percent of his share of the costs of production (effectively doubling his share of cost).
U.S Virgin Islands	*NO compulsory pooling laws*		
Utah			

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	Utah Code Ann. § 40-6-6.5	Risk-Penalty Approach	Non-consenting owners in Utah may be required to pay up to 100 percent of their share of the costs of drilling and production; additionally, they may be accessed a risk-penalty of not less than 150 percent nor greater than 300 percent of their share of the costs of staking the location, well-site preparation, rights-of-way, rigging up, drilling, reworking, recompleting, deepening or plugging back, testing, and completing, and the cost of equipment in the well.
Vermont	29 Vt. Stat. Ann. § 525	Risk-Penalty Approach	In Vermont, non-consenting owners may be compelled to pay his or her share of costs out of his or her share of production, plus a supervision, risk, and interest assessment (a risk-penalty)of up to 300 percent of that owner's share of the costs.
Virginia	Va. Code Ann. § 45.1-361.21Bottom of Form	Options-Given Approach	Non-consenting owners in Virginia may be accessed a risk-penalty fee of between 200 and 300 percent of their share of the costs of production.
Washington	*NO compulsory pooling law*		
West Virginia	W. Va. Code § 22C-9-7	Options-Given Approach *	In West Virginia, non-consenting landowners may either: 1) sell their mineral interests to participating landowners or 2) may elect to participate on a limited basis (without sharing full costs) on terms to be determined by the board entering the order.
Wisconsin	*NO compulsory pooling law*		
Wyoming	Wyo. Stat. § 30-5-109	Risk-penalty approach	Wyoming uses a risk-penalty approach, through which non-consenting owners may be required to pay their full share of the costs of production, plus up to 300 percent of their share of the costs and expenses of drilling, reworking, deepening or plugging back, testing and completing. In addition, non-consenting owners may be required to pay up to 200 percent of their share of any new equipment costs.

*Pennsylvania and West Virginia include statutory language that exempts compulsory pooling laws in the the Marcellus Shale region. Statutory provisions in those states apply only to mineral resources outside of the Marcellus Shale formation.

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