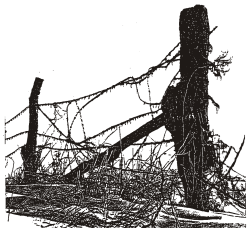

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MEMO

From: Dave McMahon, J.D., Co-Founder

To: Oil and Gas Conservation Commission

Date: 2018-05-09

Re: Requests to Commission for rulemaking/action

Note all page and line references are to the "Committee Substitute" version of the bill available on the Legislative web site that shows changes from current code, but may not have stylistic changes included in official "enrolled" bill that is also on the website.

Conservation Commission's powers under HB 4268

There are actually two provisions in the bill which give the Conservation Commission power regarding the 2018 Cotenancy statute.

•W.Va. Code 22C-9-4 was amended by, in part, adding (page 6, lines 73-76) this new subsection:

> (j) The commission is hereby empowered and it is the commission's duty to execute and carry out, administer, and enforce the relevant provisions of §37B-1-1 et seq. of this code concerning mineral development by cotenants for all wells at all depths. The commission has jurisdiction and authority over all persons and property necessary therefor. The commission is authorized to make such investigation of records and facilities as the commission deems proper.

•On page 11, subsection 4(f), line 70, the Oil and Gas Conservation Commission is given rulemaking authority for that entire section, not just that subsection or not just the appeals to the OGCC about the royalty or about its duties regarding terms or conditions of the working interest document.

Rulemaking that needs done.

1. The driller is required to make **"reasonable efforts to negotiate."**

❒A rule should say that this should not include the driller giving in on only the things that they could not get if the landowner takes the option for highest royalty and average bonus -- "warranty of title, jurisdictional or choice of law provisions, arbitration provisions, injection well provisions, disposal well provisions, and storage provisions" Pag 11, lines 54-56.

❒The Commission should make a rule that says reasonable efforts includes giving the landowner their net acreage, a map of the location of their land, and a reference to the tax ticket for the tract (so they can make sure taxes are paid in the future if they are not now paying them).

2. **Notice of statutory requirements/options.** The statute requires the driller to give the landowner the driller's "best and final offer". There is no requirement that the driller says that an offer is their best and final offer. The landowner has 45 days to make an election to choose an option to lease or take a working interest. However, there is no requirement that the landowner gets actual notice of their options under the statute, or their right to appeal and how to appeal.

❒A rule should require the landowner to be told the offer is the best and final offer and of their rights to the options under the statute and to an appeal etc.

3. **"Delivery" dates should be postmark dates for cotenants.** People in rural do not have experience with/access to private overnight companies, and rural post offices are getting shut down, so even U.S. postal service overnight is difficult. Lots of other legal rules say that "delivery" means putting it in the US Mail with a post mark of the required delivery date. This is not a problem for operators so actual delivery with a return receipt from the Postal Service or Fed Ex, UPS etc. could still apply to drillers.

❒A rule should be adopted that "delivery" by a cotenant means postmarked on the required day. Use of return receipt by operators is not a burden so they could be required to show return receipt to show "delivery".

4. **Notice of highest royalty, average bonus.** The landowner can take the option for the highest royalty and average bonus, but how does the landowner find out what that is in the following situations: 1)Before deciding between working interest and royalty interest options. 2)When deciding whether to appeal within 30 days of the date the landowner "has chosen" the royalty/bonus option.

❒A rule should require the driller to give the landowner notice of what they would get if they choose the first option before having to make a choice.

❒In the alternative, so the landowner can decide whether to appeal, a rule should require the driller to give the landowner notice of the amount of the highest lease and the average signing bonus within a week of the landowner election.

5. **Determination of "consenting cotenants'" highest royalty/average signing bonus.** The statute says that a non-consenting cotenants gets the highest royalty and average signing bonus of "his or her consenting cotenants". That should be any consenting cotenant, not just the first 75%. It should function like a "most favored nation" clause that is not uncommon in the industry. If not, the driller will get 76% of the cotenants sign (say at 12.5%) and give the option

to the 77th who takes the royalty clause option and only gets 12.5%. Then #78 says that the 12.5% offer is ridiculous and says he will take the working interest option instead -- so the driller gives in and says, "OK we'll give you 14%" and #78 takes it. If that happens, #77 should get 14% and not 12.5%.

Also, the "highest royalty" should include any overriding royalties negotiated with consenting owners in addition to their production royalties. This would give the nonconsenting owners the benefit of any "sweetheart" deals. For instance, if 74% of owners sign for 12.5% and there is a 1% owner who wants 18% royalty, the company can give that 1% owner an ORRI of 5.5% and a production royalty of only 12.5% in order to keep the remaining, non-consenting owners at 12.5% royalty.

❒A rule should say that the "the highest royalty percentage paid to his or her consenting cotenants" functions as a "most favored nation" provision and applies to any lease signed, not just the first 75%.

❒A rule should state that "highest royalty" includes overriding royalties and other such payments to a cotenant.

6. **Other terms and conditions.** Subsection 4(e) (page, 11, lines 50-53) gives the driller option to ". . . benefit from the other terms and provisions defined by the lease executed by a consenting cotenant which contains terms and provisions most favorable to the nonconsenting cotenant or the unknown or unlocatable interest owner . . ." How does the landowner find out what the terms of the other leases are? Even the hearing provided in at page 10 lines 31-36 does not appear to be on the best terms provision in (c), just the highest royalty and average signing bonus in (b)(1).

❒Rulemaking should require the driller to send landowners the leases or at least let them look at them in a local setting. The commission would be overwhelmed if it tries to decide all of these.

❒If the commission is going to try to decide, the Commission needs a rule that provides for a way to hear from the landowner in writing or at a meeting or hearing of some kind on what the landowner thinks are the important terms in a lease.

7. **What interests/formations can go to surface owner?** Page 11, subsection (4)(e), limits the leasing under this new chapter to the formation that is proposed to be produced. It says on lines 58 to 60, "[N]onconsenting cotenants AND unknown or unlocatable interest owners will retain all rights to all other formations unless or until reasonable efforts are made to renegotiate under this section for each additional formation. [Emphasis added]" That makes sense for "non-consenting" cotenants. It does not make sense for "unknown and unlocatable" cotenants, since they cannot be found to have reasonable efforts to negotiate other formations! They could not be found in the first place for this formation!

There is a conflict in the bill/code with language on page 12 subsection 4(g), lines 58 through 60. There it says that if an unknown or unlocatable interest has not been claimed for 7 years, then the surface owner can go to court and have title transferred to them "of ANY AND ALL unknown or unlocatable interest owners in AN oil and natural gas estate which underlies the surface tract. [Emphasis added]" That seems to be broader than just the formation stated in the earlier Code section. The severance of mineral and surface interests is a terrible burden on industry, makes surface owners uncooperative etc.

❒The Commission should adopt a rule that says there is potential conflict in the bill/code, and it interprets the statute to mean that the entire column of oil and natural gas is subject to the surface owner getting title (unless another formation is separately deeded in the chain of title) that belonged to missing and unknown cotenants. That will make it easier for future drilling of other formations, reunite the surface, and the people who might be hurt for it could not be found in the first place and have not shown an interest for seven years. That rule would also be consistent with the existing provisions of West Virginia Code §55-12A-1, *et seq*.

8. **Surface owner consent to Commission.** [It might be best to read #9 below first.] The deep well statute which was enacted many years ago requires surface owner consent. The Commission requires the surface owner's consent to be sent to the commission as part of the well work permitting process for a deep well. The same should be true for the surface owner's consent required by the 2018 Cotenancy statute as part of the permitting process.

Language clearly limiting the requirement of surface owner consent to only when the statute was used for the mineral tract under the surface tract being disturbed was in the House Energy Committee version of the statute ("on, the surface of or above such tract of minerals "). But that language was taken out by House Judiciary based on the surface owner argument that even if the tract was not the tract under the surface owner, the cotenancy statute made longer well bores from the surface owner's tract possible which meant a longer presence on the surface owner whose land was being disturbed with more trucks talking materials to and fluids from the well, more light, more noise, more air emissions etc. When the bill was explained to the House of Delegates by John Shott, Chairman of House Judiciary, as the bill was up for passage on third reading, he told the House that the surface owner consent requirement applied even if the mineral tract for which the Chapter was used was "maybe even a mile" from the mineral tract under the surface owners.[1] [2]

The D.E.P. is already on record saying that based on the studies it did pursuant to the Natural Gas Horizontal Well Control Act of December 2011 surface owners need more protection. According to D.E.P.'s May 28, 2013, cover letter to the President of the Senate and the Speaker of the House, the studies shows the need , ". . .[T]o reduce potential exposures. . ." and ", , ,to provide for a more consistent and protective safeguard for residents in affected areas."

❒A rule should require the permit applicant to submit a surface owner consent document signed by the surface owner for any tract upon which surface disturbance occurs if the surface disturbance is for a well the vertical or horizontal well the bore of which penetrates a mineral

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[1]See Chairman Shott's explanation at four hours and thirty minutes into the House Floor session of 02/15/1918 can be found at https://www.youtube.com/watch?v=lgwOi1U_Ms8&list=PL2q3Wbz7wKWXbMV02AJO4PWL8PuZMKFs7&index=2 .

[2]Senator and Judiciary Chairman Trump was asked a question when the bill was up for passage in the Senate without any amendments by the Senate, and his explanatino fo the bill was not thes same -- he explained it the way the previous year's Senate bill his committee drafted passed the Senate and died in the House without the change made to the 2018 Cotenancy bill by House Judiciary -- that surface owner consent was only needed if the 2018 Cotenancy bill was used for the tract under the disturbed surface. But it was Chairman Shott's amendment and Delegate Trump was probably confused based on what he had drafted the year before.

tract for which the 2018 Cotenancy statute is used, or is for a vertical or horizontal well bore which drains from a unit which includes a mineral tract for which the 2018 Cotenancy statute is used.

9. **Notice to surface owner.** The statute requires surface owner consent if the statute is used as explained in the next item.

❒A rule should require the driller to notify the surface owner of the driller's need for surface owner consent pursuant to the statute so that the surface owner will know his or her rights under the statute passed by the Legislature before negotiating a final surface use agreement. If this is not done, any surface owner consent signed before notice should be invalid.

10. **Information to Treasurer.** The treasurer in 37B-2-5(g) at page 16 lines 28-34 is required to publish a notice in the paper after 7 years giving surface owners notice of their right to claim future royalties and title. In 37B-25(b)(4) the administrator is may enact a rule for other information the driller has to supply to the administrator. This should include a map that can be published to help people find if it is their property.

❒A rule should require the driller supply some kind of map and include surface property tax map and parcels (even though the latter may be dated by the time the publication occurs). [This rule may be for the treasurer to do.]

11. **"Future" vs "remitted".** Is there a way that 37B-1-4 can be interpreted by rule so that once a quiet title action is filed, the driller can hold the money pending the outcome. That would make a lot of money that the surface owner could use to afford a lawyer to being the quiet title suit.