

Feb 8: MEC Compulsory Pooling Mtg. Pittsboro

This meeting covered Ownership of Oil and Gas Rights (surface estate and the mineral estate); Mortgage loans and effects of natural gas drilling; Overview of Compulsory Pooling in five oil and gas producing states; discussion.

Note: The State has "police powers" for compulsory pooling; it is not Constitutional authority.

1. NC General Assembly extinguished all "ancient" oil and mineral rights in 1986. If you "claimed" you owned mineral rights, had to show a chain of title back 30 years, define the property boundaries, and list that land with the county tax office, per G.S. 1-42.9. HOWEVER, if the county failed to publish notice of this law for four consecutive weeks (proof required) to comply with statute, extinguishment might not apply in that county. Could be court challenges: Someone can claim they "own" mineral rights even if they did not follow the 1986 law, especially if the owner was underage or incompetent. There was a 1994 NC Supreme Court case where a railroad right-of-way was extinguished...the railroad won the suit to reclaim the property because of lack of due process. Suggestion from Attorney General's person, Lynn: Hire an attorney to investigate. If a mineral "owner" has not paid local taxes, that does not mean the claim is extinguished. Messy and unclear. Chatham Co has 2,500 acres under two deeded leases along Deep River. History: Chatham County extended on both sides of the Deep River until Lee County was formed in 1907.

2. Lee County's Geographic Information System reveals extent of leases and property ownership. Don Kovasckitz, Lee County, said three types of property owners: unified owner who owns surface and subsurface; split estates between surface and mineral interests thru leases; and "severed estate" where the mineral interest can be transferred/sold by deed separate from the surface owner. If property rights are owned by two separate entities (surface owner, subsurface owner), they must be listed separately with tax assessor. Lee County found 35 severed parcels, comprising 5,500 acres and they pulled deeds to research specifics about the area owned. Some deeds are very vague, but the GIS was able to match property descriptions on old deeds from 1800s, with two exceptions. The top 3 severed estate owners are J. Daniel Butler (biggest), International Paper, and Weyerhaeuser.

There are 7,800 acres showing as split estates, but the tax assessor is recording less acreage. Leases (not severed estates) are held primarily by Whitmar Exploration (5945 acres, 20-year leases, mainly signed between 2010-2012) and Tar Heel Natural Gas (930 acres, 3 year leases). Some of these leases overlap with boundaries of "severed estates" on the map. A buyer of a mineral lease "should" record it at the Land Records office, for their own protection.

Questions: When does a mineral right expire, and is a new surface owner bound to the mineral lease agreements? General Statute 47.E does NOT require a deed disclosure pertaining to oil or gas rights. However, that disclosure is required in a “contract for sale.” That means that older deeds may NOT reveal whether you have “severed” mineral rights. The new 2012 law, S820 requires ALL lease holders to notify surface land owner when mineral rights are sold to another entity. Hire an attorney to do mineral rights title search, a title search is insufficient if the mineral rights are older than 30 years.

Wells. The Lee County GIS also mapped every water well, or at least 97% based on comparisons to Sanford water bills. Where households exist outside of water service areas, the assumption is that you have a well.

3. Mortgage Loans and USDA backed Mortgages. John Humphrey, attorney. Banks have a security interest in mortgage, as a lien on the property.

The “due on sale” clause in a mortgage means if any part of property is sold or transferred, must tell the Lender who can require immediate payment-in-full of all sums secured.

Fannie Mae says can approve requests for mineral rights on behalf of Fannie Mae if lease is “customary” in the area....an unknown in NC!

Fannie Mae concerned about extent of rights of lease that infringe on surface rights of owner; “borrower shall not cause or permit presence, use, disposal of Hazardous substances [i.e. toxics, gasoline, pesticides, radioactive, other flammable petroleum products] that effects a condition that adversely affects the value of the property.” Fannie Mae also says cannot do anything to create an environmental condition; obligation to lender to not destroy, damage, or commit waste...could declare loan in default and foreclose.

Lenders, such as SECU and NC Housing Finance Agency will refuse mortgages on severed estates and properties with gas leases—based on their current risk assessment.

Environmental clean-up concerns. Banks don’t want liabilities when they can’t quantify clean-up and litigations costs. Would State take over liabilities? Lenders want to be indemnified by drillers. There is also the secondary mortgage market Freddie Mac with “warranties and representations” to buyers about risks.

USDA backed mortgages. The National Environmental Policy Act (NEPA) requires federal agencies to ID federally funded programs with significant impact on the environment. USDA applies NEPA, by directive, to USDA backed mortgages. If Compulsory Pooling on land with USDA mortgage, the added value from share of royalties must be paid to lienholder (USDA) first, not just the landowner.

Compulsory pooled landowners with mortgages face several issues. Could be default on mortgages; definite impact on homeowners insurance [Example from Nationwide Insurance: they will NOT cover damages from hydraulic fracturing and other aspects of natural gas development]; and surface owner at disadvantage in negotiating terms with insurer who wants to be indemnified by driller.

4. Five oil and gas producing states and compulsory pooling rules. DENR volunteer attorney, Layla Cummings.

Defined terms:

Pooling = combining leases to prevent waste, get maximum efficiency out of a drilling operation.

Compulsory = area officially drained by one well.

Unitization = A common source of supply

Some states have adopted "Pugh Clause" to preserve the entire lease track even if only a portion has been pooled; then release land [to whom?] after a period of time has elapsed.

Arkansas: Must have 50% voluntary acreage agreement for exploratory units, and 75% voluntary acreage before "compulsory unitization." "Good faith" offer to landowners.

Colorado: Must have 80% voluntary acreage agreement, "good faith" offer, if party objects can go to hearing.

Ohio: Mandatory pooling for conservation; written consent for surface operations; recommends 90% voluntary minimum acreage to apply for Compulsory Pooling; 65% voluntary minimum acreage for compulsory unitization; No other alternative location for drilling unit [rules updated 2010]

Texas: No compulsory unitization; no minimum voluntary acreage required for compulsory pooling; make fair and reasonable offer; automatic dissolution of a unit if NO production within one year. TX has 100,000 gas and oil wells.

West Virginia: Pooling not available in shallow wells; Deep wells, 75% voluntary minimum acreage; owner consent for surface operations [Built their scheme based on shallow wells, deep wells, and secondary recovery]; new law 2011 SB424 addressed forced pooling in Marcellus shale that extends to WV.

Layla suggested: Retain compulsory pooling, but operators must make fair and reasonable offer to landowners; require consent of surface owners for surface operations; have a time-certain dissolution of pools.

Question: Compulsory unitization versus compulsory pooling, still unclear. Charles Holbook, gas expert, says unitization means that all owners under the horizontal distance of the drilling get a fair share of revenues.

Diana Hales, retired