

## March 27: MEC Compulsory Pooling Mtg. Sanford, NC

*Note: All Study Groups report to full Mining & Energy Commission. Study Groups have numerous "invited" members representing various government sectors, public and private interests. Their recommendations will "advise" the Legislature regarding future laws.*

Study group chaired by Ray Covington (MEC members attending: Jim Womack and Charles Holbrook).

1. Approved "use of surface" recommendation: *No surface operations or disturbances to the surface of the land shall occur on a tract pooled by an order without the written consent of or a written agreement with the owner of the tract that approves the operations or disturbances.*
  
2. Review of cost-sharing statutes from NY, AR (Arkansas), CO, OH, TX, WV on working with "hold-outs" in a compulsory pool. This relates to receiving a share of royalties when a well produces. Three approaches:
  - (a) Free ride (currently NC law) allows non-consenting owner to share in profits from production with NO risks or cost involved with exploration or development. Encourages hold-outs from joining voluntary pooling agreements.
  - (b) Risk penalty. When a well is successful, hold-out is assessed a percentage of production costs to reimburse the operator for the risk of development and drilling. This share of costs is withheld from royalties, along with an additional percentage of "risk penalty" of 200%, or more. Half the states use this approach.
  - (c) Surrender of working interest. The hold-out can assign their interest to the operator in exchange for a bonus payment, and/or royalty interest...sort of like a lease with the operator. "Just and reasonable" terms would be determined by the oversight body (MEC, DENR?) and give landowners several choices for royalty distribution, sharing production costs of the well, and perhaps additional risk penalty. Discussion about length of lease with operator in this case.

Establishing "drilling units" are the responsibility of MEC [*Womack says may have to do this before October 2014*]. Don't want to divide a parcel so it ends up in different units or pools. Rough standard acreage for a drilling unit is 640 acres. Holbrook said since a horizontal run (the fracking part) can go 1,000 to 2,000 ft., a drilling unit might extend into a neighboring drilling unit. Unanswered questions about liability for the landowners forced into the pool in the event of a well blow-out. Strategy is to encourage everybody to lease, not hold out. Even competing operators can be "compelled" into a drilling unit. From the other side, need to provide a way for land owners (or operators) to petition for inclusion into a pool. Group seemed to prefer the Risk Penalty approach (see b). Holbrook says risk penalty

percentage should be linked to the market price of MCF (million cubic feet) of natural gas...the lower the market price for gas, the higher the assessed percentage of risk penalty.

3. Discussion about six stages of a lease; rights of unleased land owners; and the split estates where surface and mineral rights are severed. Covington said there are 100 property owners in Lee Co. that have split estates (by deed). Discussion regarding estates (surface owners and/or subsurface mineral owners) whose property is divided with multiple heirs; not all can be located. A problem. At this time, the NC surface owner has primacy over subsurface lease holder.

4. Outline of potential issues for study report, offered by member, Atty. John Humphrey: Indemnification of subsurface and surface owners; pooling of special lands (ex. churches, local govt. property); setbacks; geographic scope of pooling unit; time limitations; water and air testing; costs; payment structures and reports to landowners; due process.

5. *Pearls:* Womack said NC, with our shallow shale, should not chase industry away, even though NC will attract smaller operators. Holbrook said not to worry about smaller operators because there are a limited number of companies that do the drilling, casing, and cementing; and all operators use only these companies. [*Hmmm, so how will this create NC jobs?*] Holbrook said when the operator takes control, that company is in charge of the surface as well as the subsurface. Womack said the federal Bureau of Land Management wants to establish its own water use rules for their managed lands, and NC should "fight" to make the feds use state rules. Womack said need to increase "demand side" for NC's own natural gas with Regional Economic Development councils, PSNC and Duke Energy.

**Local Government Study Group** chair Charles Taylor, absent; Jim Womack controlled meeting. (MEC member attending: Charles Holbrook.) Held in Sanford.

1. Local Zoning and Regulations. Bob Bridwell, Director, Sanford/Lee County Planning Dept., said Lee Co. (unlike Chatham and Moore) has county-wide zoning and operates under a unified development ordinance (UDO) for entire county/municipalities that covers all land use regulations, including zoning, building codes and flood plain management. There are 25 counties that have a UDO, the rest of the counties either have NO zoning, or piecemeal along highway corridors. If NC legislation prevents local governments from using their zoning and nuisance abatement authority, Lee Co. will focus its regulatory perspective on ancillary activities (water & waste treatment lines, gas lines, pumping stations, material storage, trucking and fuel terminals, worker housing). Womack, a Lee County Commissioner, said that state legislation could "override local authority and will not allow local land use to interfere with drilling." Bridwell said public utility (gas) lines are allowed across all property zones in

UDO. Discussion on how to treat special districts (i.e. voluntary agricultural districts) that could co-exist on same parcel that might be fracked. NC Assoc. of County Commissioners rep said to keep zoning authority at the county level. Bridwell said because of the differences between counties, the MEC should request minimum regulations that would apply to all. Holbrook said PA is “onerous” for industry since each township (sort of like a mini-county) has different rules and the industry has to negotiate with each one separately. NC Institute of Government representative said noise restrictions might need to be different depending on location of well. Also said to set a standard and cede to local authority, without granting the ability to shut the operation down, but be able to grant waivers to achieve reasonable accommodation.

2. Property taxes. Bridwell said that land use is determined by the surface only; no differentiation for subsurface use. He seemed to favor “special-use permits” to establish standards for Board of Adjustment process. Discussion on how to treat special districts (i.e. voluntary agricultural districts) that could co-exist on a parcel that might also be fracked. This is tax question because of present-use-value (ex. a reduced property tax rate on agricultural land) when same property owner could receive royalty returns from a productive well. NC Assoc. of County Commissioners representative suggested drawing a line between present-use-value to exempt it from mineral bonanza (if it occurs). Discussion about increase/decrease in value of surface land if the mineral lease interferes with future development of surface. Need NC Dept. of Revenue input on how to tax royalties, since *ad valorem* tax should be paid to county. Would that be an appraised value or actual value of minerals extracted? Womack had interesting point about the January 1st county property tax listing that asks everyone to declare property (boats, RVs, unlicensed vehicles, etc.) for taxation where it resides. He said some companies actually move equipment from one NC county to another NC county to take advantage of the lowest property tax rate.

3. Fracking Wastewater to Cumnock? Womack asked if new wastewater plant in Cumnock could handle flowback waste. Lee Co. Public Works said it would need pretreatment FIRST since this plant is designed for domestic waste only. Womack asked if the pretreatment facility could be built at the same site, or in proximity. Holbrook says Halliburton says they can do pretreatment; and by the time the industry “arrives” in NC, there will be a pretreatment process and less water will be used. Holbrook mentioned the industry’s Trade Secret fracking compounds are now beginning to substitute “green” chemicals for toxic chemicals, and “problems will be over in two to three years.”

4. Setbacks are issue, but from what---homes, property lines, schools, streams?

5. Authority to make decisions on gathering lines? Womack said this is a question for Attorney General, but doesn't want this to be a "special restriction" for the oil and gas industry. This topic handed over to Holbrook's Administration of Oil & Gas Committee to investigate.

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