House
Legislative
Analysis
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COMPULSORY POOLING OF MINERAL RIGHTS

House Bill 5317 (Substitute H-1)
First Analysis (11-6-97)

Sponsor: Rep. Allen Lowe
Committee: Forestry and Mineral Rights

THE APPARENT PROBLEM:

Part 615 of the Natural Resources and Environmental Protection Act (NREPA), regulates some of the ways in which property owners lease their mineral rights for oil and gas exploration and development, and delineates the responsibilities of the "Supervisor of Wells," who is really the director of the Department of Environmental Quality (DEQ). Part 615's provisions are designed to "foster the conservation of natural resources." In other words, to prevent the state's gas and oil resources from being wasted needlessly, to assure that oil and gas development doesn't occur in a scattered, unconsolidated fashion, and to ensure that all this is accomplished through sound conservation policies. Accordingly, under the act, parcels of land are usually pooled to form a "drilling unit," in which only one well is drilled. Each property owner in a drilling unit is a partner in the development, and is referred to as a "royalty interest owner." Each receives a royalty interest, based on that owner's proportionate share of the acreage in the drilling unit, or on the terms of a lease arranged with the gas or oil company.

The pooling process is designed to prevent oil and gas development from being scattered across the landscape. However, it sometimes happens that a land owner doesn't wish to join a drilling unit pool. Many have discovered that they have few rights in such situations: if a gas or oil company can't establish a drilling unit because a minority of leaseholders are holding out, then the company may petition the DEQ to require compulsory pooling. Such requests are rarely denied, because the intent of the act is to ensure that a majority of mineral owners who want to develop their resources aren't prevented from doing so by a minority of those who refuse to lease. In recent months, however, property owners have complained in increasing numbers that oil and gas companies are abusing this law. In some cases, property owners report that the companies have used the "forced pooling" provisions to pressure them into signing leases. Other property owners complain that the companies have used the provisions to avoid negotiating the terms of leases. Accordingly, legislation has been introduced that would prohibit forced pooling under certain circumstances.

THE CONTENT OF THE BILL:

At present, the Natural Resources and Environmental Protection Act (NREPA) permits the "pooling" of properties with regard to mineral rights. In this context, "pooling" refers to the practice of combining parcels of land to obtain a "drilling unit," which is the maximum area that may be drained by a single well. (Note: other drilling areas are defined within the act: a "proration unit" is a unit for which a limit has been set on the volume of oil or gas that may be produced from a well for a specific time period. Also, when several wells are drilled and the shares are co-mingled, the development is referred to as a "uniform spacing plan"). The act also specifies that the supervisor of wells (the Department of Environmental Quality [DEQ]) may require pooling if the property owners involved do not agree upon the provisions for pooling, and the shape or smallness of a separately owned tract means that the owner probably would not recover an equitable share of the oil or gas in the pool should a uniform spacing plan be enforced.

House Bill 5317 would amend the NREPA to specify that the DEQ could not require pooling if the majority of the property owners who owned the mineral rights within an area decided against it. Under the bill, the supervisor of wells could not require the pooling of properties or parts of properties unless the owners of a majority of the mineral rights in the drilling or proration unit or area subject to a uniform spacing plan had leased their oil and gas rights or otherwise agreed to pool their interests in the proposed unit or area.

MCL 324.61513

FISCAL IMPLICATIONS:

According to the House Fiscal Agency (HFA), the bill would result in an indeterminate increase in state revenues, since it would reduce the chance that state-owned gas or oil minerals would be "drained" by owners of adjoining mineral interests. (11-4-97)

According to the Department of Environmental Quality, the bill would have no fiscal impact. (11-4-97)

ARGUMENTS:

For:

Many mineral rights owners maintain that current laws deprive them of their constitutional rights to due process. If a gas or oil company obtains leases from a majority of the mineral rights owners on a parcel of land, it may then combine the parcels to form a "drilling unit," in which one well will be drilled. Alternatively, it may combine several wells under a "uniform spacing plan," in which the shares are co-mingled. If a minority of the property owners who own the mineral rights with a proposed drilling area refuse to join the drilling unit and lease their mineral rights to the gas or oil company, the company may then petition the DEQ to require compulsory pooling. When this happens, the dissenting property owners (known as "holdouts") have little recourse, since the intent of the act is to ensure that mineral owners who want to develop their resources aren't prevented from doing so if they constitute a

majority. No drilling will take place on the holdout's property, but the tract of land will be developed with or without the holdout's consent.

The rules promulgated under Part 615 of the Natural Resources and Environmental Protection Act (NREPA) which pertain to compulsory pooling (R 324.304 et al.), specify that a "holdout" has ten days after an order for compulsory pooling is issued to decide between two options. First, he or she may pay the company the proportionate share of the cost of drilling, completing, and equipping the well, whether the well produces oil or is a "dry hole." Alternately, he or she may await the outcome of the drilling of the well, and, if it is a producer, pay the company the proportionate share of the drilling costs, and, in addition, an additional percentage designed to offset the company's risk of hitting a dry hole. If no option is chosen, he or she is deemed by the DEQ to have elected alternative number two.

Environmental organizations and mineral rights owners who have been involved in this process maintain that these provisions deprive them of a bargaining position with oil and gas companies involved. For example, there is no incentive, under the act, for these companies to make any effort to negotiate with mineral rights owners before petitioning the DEQ for compulsory pooling. Some property owners report that they were, in fact, interested in leasing their mineral rights, but were never given the chance to negotiate a contract. Others, who attempted to negotiate different leases, report that they were arbitrarily dropped from the proposed drilling unit. In some cases, mineral rights owners were given only seven days to respond to a company's request informing them of the company's proposed plans.

Against:

As proposed in testimony before the House Forestry and Mineral Rights committee, the bill should specify that negotiations over mineral rights leases in these situations would have to be submitted to arbitration, according to the rules and regulations of the American Arbitration Association, should parties (oil or gas companies, on the one hand, and mineral rights owners, on the other) fail to reach an amicable agreement. Otherwise, the bill, as written, contains no provisions that would strengthen the bargaining position of mineral rights owners. Specifically, the bill would require that compulsory pooling could not be ordered if the majority of the property owners who owned the mineral rights decided against it. However, according to the DEQ, this practice is currently in place. In addition, according to the department, compulsory pooling is rarely requested in cases where less than half of the mineral rights owners have signed leases.

POSITIONS:

Mineral rights owners from northern Michigan testified before the House committee in support of the bill. (11-4-97)

The Department of Environmental Quality (DEQ) supports the bill. (11-4-97)

The Michigan Energy Reform Coalition (MERC), an alliance of environmental groups that includes the Michigan Environmental Council and the Michigan Land Use Institute, would support the bill if it included an amendment specifying that oil and gas companies must show a reasonable effort to negotiate with mineral owners before petitioning the DEQ for compulsory pooling, and also one that defined "reasonable effort." (11-4-97)

The Michigan Association of Realtors has no position on the bill. (11-5-97)

The Michigan Municipal League has no position on the bill. (11-5-97)

Analyst: R. Young

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.