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ENERGY IN THE LAW

Wyoming Oil and Gas Conservation Commission Adopts Operatorship Rule

On November 12, 2019, the Wyoming Oil and Gas Conservation Commission (Commission) adopted a rule first proposed about four months ago, which aims to alleviate various well permitting problems in Wyoming. Currently, a company can establish operatorship control (the right to drill wells) for an indefinite period of time by saturating an area with applications for permits to drill (APDs) and renewing them *ad infinitum*. Additionally, the Commission is experiencing an unprecedented overload of APD submittals and contested operatorship hearings. This APD backlog and mechanism for locking up acreage have attracted considerable attention recently.

Royalty owners, certain state legislators, and even some exploration and production companies have argued that the current system discourages drilling and new investment by allowing companies to lock up acreage. Other companies have argued that the system encourages investment and extraction by creating regulatory certainty and reliable drilling blocks. In any case, early in 2019, Governor Mark Gordon and the state legislature considered measures to reduce the permit backlog and number of operatorship disputes that have recently dominated Commission hearings. The legislature declined to pass any laws in 2019, and instead committed to tackling the issue in interim committee meetings between the 2019 and 2020 legislative sessions. In lieu of a legislative resolution, the Commission has instead adopted new regulations aimed at reducing permit backlogs and incessant operatorship disputes. The Commission stated that the rule "is intended to provide a 'level playing field' for all operators with intent to drill and develop minerals within the state of Wyoming."

The rule creates a modified "race to permit" system, where the first company to file an APD or spud a well in a horizontal well drilling and spacing unit (DSU) will be entitled to all of the APDs in that DSU. The rule clarifies that a DSU is specific to a pool (in other words, a formation). Notwithstanding the first-to-file provision, a competing operator may seek its own APDs in a DSU where another company already won the race to the first APD. This mechanism is best explained in the context of a hypothetical example.

In this hypothetical, two companies wish to drill wells in the Niobrara Formation in a DSU. First File, LLC submits a Niobrara APD in the DSU, which goes into the Commission's queue. Months later, Runner Up Inc. submits a Niobrara APD in the DSU. Under the rule, the Commission will reject Runner Up's APD. However, Runner Up is not out of options. Runner Up may file an application for hearing, which must be filed within: 1) 30 days[1] of receipt of a horizontal well application notice from First File or 2) 15 days of any 2-year anniversary of the spud of a well. This is referred to as an 8(m) application.

Per the rule, Runner Up's 8(m) application must contain:

a. A copy of the submitted APD(s) requested for approval;
b. A description of the technical ability and experience to drill and complete similar wells;
c. Percentage of working interest ownership within the DSU and any written support from other working interest owners in the DSU;
d. Working interest ownership in the area;
e. The number of operated wells producing or capable of production within the DSU;
f. The number of wells operated in the surrounding lands;
g. Status of any necessary Federal permitting;
h. Contractual obligations, if any;
i. If the well pad is on Fee surface, proof that negotiations have commenced between the Owner/Operator and surface owner;
j. Proof of delivery of Authorization for Expenditure (AFE) and Joint Operating Agreement (JOA) to all other Owners/Operators and unleased mineral interest owners in the DSU.

First File may submit a protest of Runner Up's application. Per the rule, the protest must contain the same information submitted by Runner Up in Runner Up's 8(m) Application. Prior to hearing, Commission staff will review the APDs from each company, and presumably provide that review to the Commission.

The rule requires the Commission to consider all of the information contained in Runner Up's application and First File's protest, along with "other relevant evidence." If the Commission determines that both parties' cases are equally compelling, the rule directs the Commission to break the "tie" in favor of the company with the largest working interest. This is known as a "plurality tie break" and Wyoming is the only state in the Rocky Mountains to have adopted such a system. This plurality tie break may eventually become a very important part of the rule. In many of the contested hearings heard by the Commission over the past several years, the Commission has commented that both parties' cases are equally good, and it has struggled in how to break the tie. If past behavior is a good predictor of future performance, this express, relatively objective criterion, will likely play a very important role in contested 8(m) applications.

The rule also addresses situations where First File is renewing an existing APD or has already spud a horizontal well (as opposed to having an approved APD in the DSU). Similar to the first hypothetical, Runner Up may file an 8(m) application for First File's renewal to be denied. Alternatively, if First File already spud a well, Runner Up may file an 8(m) application requesting that the Commission approves Runner Up's APD, notwithstanding the fact that First File already has a well spud in the DSU. In either case, the Commission will address the 8(m) application the same way as it would an application to deny First File's APD.

The Commission received dozens of comments about the rule that was originally proposed in July. Commission staff amended the proposed rule in response to the comments, and the redline showing the amendments is available here. Additionally, Commission staff drafted responses to comments about the original proposal, which comment responses are available here. At the Commission's hearing on November 12, 2019, Commission staff presented the redline to the Commission, which unanimously adopted the revised proposed rule with minimal discussion or debate.

The adopted rule is expected to take effect in the first quarter of 2020. After the Commission's vote, the Legislature's Management Council, the Governor, and the Attorney General review the rules, after which the Governor (who sits on the Commission and voted in favor of the rules) is expected to sign the certification for the rules.

Until the rule goes into effect, companies may still file APDs in DSUs where others have spud wells or already filed their own APDs. APDs filed between now and the effective date of the new rule will be "grandfathered" in under the old system.

Update on Wyoming Legislature's Interim Committee Topics: Statutory Pooling, Split Estates & APDs

The Wyoming State Legislature's Joint Interim Committee on Minerals, Business & Economic Development ("Committee") met at Casper College, on Monday, November 4, 2019. After a brief update on status of the Wyoming Oil and Gas Conservation Commission's rulemaking concerning APDs (see Commission update above), the Committee moved on to two of its primary interim topics concerning oil and gas operations in Wyoming. The Committee heard testimony from a variety of interests throughout the discussion on two pieces of proposed legislation concerning statutory pooling and split estates. The Petroleum Association of Wyoming ("PAW"), Wyoming Stock Growers Association ("Stock Growers"), Powder River Basin Resource Council ("PRBRC"), and the Wyoming Land and Mineral Owners Association ("WLMOA") all participated in the comment portion of the meeting. This was the Committee's final meeting before the legislative session which will begin in the newly renovated Wyoming State Capital on Monday, February 10, 2020.

Statutory Pooling

The Committee voted 13-to-1 to move forward a bill amending Wyoming's statutory pooling laws. The bill proposes to reduce the risk penalty imposed on non-consenting unleased mineral owners from "up to" 300% of drilling and completion costs to "up to" 200% of such costs for the first well in a drilling unit and 150% for all subsequent wells in that unit. The risk penalty would remain at up to 300% for any non-consenting working interest owner (i.e., oil and gas lessee).

The proposed legislation further provides for a statutory royalty for nonconsenting unleased mineral owners equal to *the greater of* 16% or the acreage weighted average royalty of leased tracts in the drilling unit. This would make Wyoming unique among Rocky Mountain states as having a statutory royalty for unleased minerals owners that potentially exceeds 1/6 (it could conceivably top 20% in certain situations).

The Committee also voted to amend the proposed bill to provide that statutory pooling orders expire twelve (12) months from issuance if the operator fails to "commence operations" within that time. However, Committee sentiment indicated that they may decrease that timeframe when they review the bill further. In addition, while the meaning of "commence operations" was briefly discussed, the Committee declined to define the term. Finally, the Committee voted to draft an amendment to the bill that would include an option for an unleased mineral owner to "opt-in" to becoming a working interest after repayment of the risk penalty. There was no language drafted for this last-minute amendment.

Split Estate Act

The Committee also considered, but ultimately failed to move forward on, proposed legislation to amend Wyoming's Split Estate Act, WYO. STAT. ANN. § 30-5-401, *et seq*. The proposed language would have imposed greater burdens on oil and gas owners and lessees before they could "bond on" to access the surface of their oil and gas leases, in lieu of reaching a surface use agreement with a surface owner. The additional requirements were patterned from the good faith negotiation requirements under Wyoming's eminent domain laws. They would have required, among other things, that an oil and gas operator provide an initial "good-faith" written offer that includes an estimate of the fair market value of the land, a discussion of reclamation, and an offer to tour the land with the surface owner.

The bill would have further removed bonding disputes from the Commission's jurisdiction and placed them in the District Court. The bill also contained awkward language targeted at changing the definition of the damages for which a surface owner must be compensated, presumably increasing such compensation. Groups such as the Stock Growers, PRBRC and WLMOA advocated for surface owner compensation equivalent to eminent domain compensation. After work on the bill that included several failed attempts at refining the compensation language, the Committee voted against the proposed legislation by a vote of 6-to-8. Ultimately, the consensus of the Committee was that, although the proposal was based on desirable outcomes, the legislation as proposed was not ready to move forward. However, several Committee members who voted against the final version of the bill expressed interest in supporting similar measures in the future, subject to resolution of several details and refinement of the language.

For any questions or concerns about the proposed and pending legislation, the implications of the Committee's actions, or the impacts of the Commission's new rule, please contact James Parrot, Nicol Kramer or Brandon Taylor.