

HOUSE BILL NO. 423

INTRODUCED BY J. POMNICHOWSKI

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4 A BILL FOR AN ACT ENTITLED: "AN ACT REVISING THE LAWS RELATED TO OIL AND GAS LEASES ON
5 STATE LAND; REQUIRING A PROVISION IN A LEASE FOR A REVISED PAYMENT IF PRODUCTION HAS
6 NOT OCCURRED DURING THE FIRST HALF OF THE LEASE; CLARIFYING THE NOTICE THAT THE BOARD
7 OF OIL AND GAS CONSERVATION IS REQUIRED TO GIVE TO THE BOARD OF LAND COMMISSIONERS
8 FOR PROPOSED SPACING UNITS OR POOLING ARRANGEMENTS; AMENDING SECTIONS 77-3-401,
9 77-3-423, 77-3-424, 77-3-430, 82-11-201, AND 82-11-202, MCA; AND PROVIDING AN EFFECTIVE DATE AND
10 AN APPLICABILITY DATE."

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12 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

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14 **Section 1.** Section 77-3-401, MCA, is amended to read:
15 **"77-3-401. Oil and gas leases authorized.** (1) The board is hereby authorized and empowered to may
16 lease, in such a manner as it may determine, ~~not inconsistent~~ consistent with The Enabling Act and the
17 constitution, any state lands land to which the title has vested in the state and in which the oil and gas rights are
18 not reserved by the United States, for prospecting and exploring for oil and gas; and for mining, drilling,
19 developing, and removing the ~~same oil and gas~~ upon the terms and conditions ~~herein~~ prescribed in this part to
20 any person, association, corporation, domestic or foreign, or municipality qualified under the constitution and the
21 laws of the state.

22 (2) ~~This~~ The power and authority to lease state lands land for such the purposes ~~shall extend~~ described
23 in subsection (1) extends to and ~~include~~ includes all lands land owned by the state under navigable lakes and
24 streams and ~~shall also extend to and include~~ all those state lands which have land that has been sold but in which
25 the oil and gas rights have been reserved by the state; ~~but in such cases and~~ However, in the case of reserved
26 rights and in all cases where the lands ~~are~~ land is under lease for grazing, agriculture, or similar purposes, care
27 ~~shall~~ must be taken in issuing the oil and gas leases to protect the rights of the purchaser or lessee.

28 (3) All leases entered into under this part must contain a provision that if production has not occurred
29 at the end of one-half of the lease period, the annual rental of the lease must be adjusted as provided in
30 77-3-423(5)."

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2 **Section 2.** Section 77-3-423, MCA, is amended to read:

3 **"77-3-423. Annual rental.** (1) The annual money ~~rentals~~ rental to be paid to the state for oil and gas
4 leases must be set by the board but, subject to 77-3-401(3), may not be less than \$1.50 for each acre of land
5 leased.

6 (2) In addition to the sum of \$1.50 per acre, the rental for the first year of the lease must also include any
7 sum in excess of \$1.50 per acre offered and accepted for the first year's rental.

8 (3) The annual rental under this section may not be less than \$100 a year.

9 (4) The first year's rental must be paid before the issuance of the lease. The rentals for each subsequent
10 year of the lease are due and payable before the beginning of the subsequent lease year. Upon failure to make
11 the rental payment, the lease terminates unless there is a well currently being drilled, a producing well, or a
12 shut-in well approved by the department on the lease. Rental paid for any year must be credited against any
13 royalty that accrues during that year.

14 (5) If production has not occurred at the end of one-half of the lease period, the annual rental of the lease
15 must be set at an amount equal to the average royalty or amount received from the top three producing wells in
16 the county or an adjacent county that are drilled into the same formation."

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18 **Section 3.** Section 77-3-424, MCA, is amended to read:

19 **"77-3-424. Power to terminate lease in absence of commencement of drilling or payment of delay**
20 **drilling penalty.** (1) ~~In~~ Subject to 77-3-423(5), every oil and gas lease granted ~~after March 3, 1955~~; under this
21 part ~~there~~ must be ~~reserved~~ reserve to the board full power to declare termination of the lease at the end of the
22 fifth year or any subsequent year of the primary term of the lease upon failure of the lessee to either:

23 (a) commence the drilling of a well for oil and gas upon the leased premises; or

24 (b) pay a delay drilling penalty as follows:

25 (i) for the sixth year of the lease \$1.25 per acre per year; and

26 (ii) for the remainder of the primary term of the lease an amount per acre per year as the board may in
27 its discretion determine.

28 (2) Notice of that determination must be given to the lessee, and if the lessee applies for a hearing
29 ~~thereon~~ within 10 days after receipt of the notice, the determination becomes final only after the hearing has been
30 held.

1 (3) This annual delay drilling penalty must be paid each year in advance. ~~The board shall refund delay~~
 2 ~~drilling penalties paid on a lease for any year in which the lessee commences drilling on that lease.~~

3 (4) If a well for oil and gas is commenced, the drilling of the well must be ~~prosecuted~~ pursued with due
 4 diligence and dispatch to ~~such the depth as that~~ such the depth as that is necessary to make a reasonable test for oil or gas."

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 6 **Section 4.** Section 77-3-430, MCA, is amended to read:

7 **"77-3-430. Pooling agreements and unit operations.** ~~Nothing contained in this or in prior related laws~~
 8 ~~prevents~~ Subject to 82-11-201 and 82-11-202, the board ~~from entering~~ may enter into agreements for the pooling
 9 of acreage with others for unit operations for the production of oil or gas or both and the apportionment of oil or
 10 gas royalties or both on an acreage or other equitable basis and ~~from modifying~~ may modify leases with respect
 11 to delay rentals, delay drilling penalties, and royalties in accordance with ~~such the~~ such the pooling agreements and ~~such~~
 12 the unit plans of operation. However, ~~such the~~ such the agreements may not change the percentage of royalties to be paid
 13 to the state from the percentages as fixed in its leases. The board may modify existing pooling and unit
 14 agreements ~~so as~~ to commit the state lands included ~~therein~~ in the agreements for as long as the unitized
 15 substance or substances for which the state ~~lands are~~ land is committed ~~is~~ are produced from any ~~lands~~ land in
 16 the unit."

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 18 **Section 5.** Section 82-11-201, MCA, is amended to read:

19 **"82-11-201. Establishment of well spacing units.** (1) ~~To~~ Subject to subsection (7), in order to prevent
 20 or to assist in preventing waste of oil or gas prohibited by this chapter, to avoid the drilling of unnecessary wells,
 21 or to protect correlative rights, the board, upon its own motion or upon application of an interested person, after
 22 hearing, may by order establish:

23 (a) temporary spacing units on a statewide basis or for defined areas within the state for oil, gas, or oil
 24 and gas wells drilled to varying depths; and

25 (b) permanent spacing units for a discovered pool, except in those pools that, prior to April 1, 1953, have
 26 been developed to such an extent that it would be impracticable or unreasonable to establish spacing units at
 27 the existing stage of development.

28 (2) The size and the shape of temporary spacing units must be established to promote the orderly
 29 development of unproven areas and must be uniform throughout the surface area and depths covered by the unit.
 30 A temporary spacing unit must remain in effect until superseded by an order issued by the board or until a

1 permanent spacing unit is established.

2 (3) Permanent spacing units do not need to be uniform in size or shape but must result in the efficient
3 and economic development of the pool as a whole. In establishing permanent spacing units, the acreage to be
4 embraced within a unit and the shape of the unit must be determined by the board based upon evidence
5 introduced at the hearing. The board may divide a pool into zones and establish spacing units for each zone if
6 necessary for a purpose mentioned in subsection (1) or to facilitate production through the use of innovative
7 drilling and completion methods. The spacing units within the zone may differ in size and shape from spacing
8 units in any other zone but may not be smaller than the maximum area that can be efficiently and economically
9 drained by one well.

10 (4) An order establishing temporary or permanent spacing units may permit only one well to be drilled
11 and produced from the common source of supply on any spacing unit, and the well must be drilled at a location
12 authorized by the order, with an exception as may be reasonably necessary. The exception may be included if,
13 upon application, notice, and hearing, the board finds that the spacing unit is located on the edge of a pool or field
14 and adjacent to a producing unit or, for some other reason, that the requirement to drill the well at the authorized
15 location on the spacing unit would be inequitable or unreasonable. The board shall take action to offset any
16 advantage that the person securing the exception may have over other producers by reason of drilling the well
17 as an exception. The order must include provisions to prevent production from the spacing unit from being more
18 than its just and equitable share of the producible oil and gas in the pool.

19 (5) An order establishing temporary or permanent spacing units for a pool must cover all lands
20 determined or believed to be underlaid by the pool and may be modified after notice and hearing by the board
21 to include additional areas subsequently determined to be underlaid by the pool.

22 (6) The board, upon application, notice, and hearing, may increase or decrease the size of a temporary
23 or permanent spacing unit or permit the drilling of additional wells in a spacing unit for a purpose mentioned in
24 subsection (1).

25 (7) The board shall give notice, as provided in 82-11-141, to the board of land commissioners of any
26 spacing unit under consideration that is adjacent to any state land or that is proposed to include any state land."

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28 **Section 6.** Section 82-11-202, MCA, is amended to read:

29 **"82-11-202. Pooling of interest within spacing unit.** (1) (a) When two or more separately owned tracts
30 are embraced within a temporary or permanent spacing unit or when there are separately owned interests in all

1 or a part of the spacing unit, then the persons owning those interests may pool their interests for the development
2 and operation of the spacing unit.

3 (b) ~~The~~ Subject to subsection (4), the board, upon the application of an interested person, may enter an
4 order pooling all interests in the permanent spacing unit for the development and operation of the permanent
5 spacing unit and the allocation of production if the applicant has made an unsuccessful, good faith attempt to
6 voluntarily pool the interests within the permanent spacing unit. The applicant must be a person who owns an
7 interest in the oil or gas underlying the permanent spacing unit or who has drilled a well, proposes to drill a well,
8 or proposes to conduct other operations on a well, including recompleting, deepening, or stimulation. The pooling
9 order must be made after a hearing and must be upon terms and conditions that are just and reasonable and that
10 afford to the owner of each tract or interest in the permanent spacing unit the opportunity to recover or receive
11 without unnecessary expense a just and equitable share of the oil or gas produced and saved from the spacing
12 unit. Operations incident to the drilling of a well upon any portion of a permanent spacing unit covered by a
13 pooling order are considered, for all purposes, the conduct of the operations upon each separately owned tract
14 in the spacing unit by the several owners of the tracts. That portion of the production allocated to each tract
15 included in a permanent spacing unit covered by a pooling order must when produced be considered for all
16 purposes to have been produced from the tract by a well drilled on the tract.

17 (2) (a) As to each owner who refuses to pay the owner's share of the costs of development or other
18 operations referred to in subsection (1), the order must provide for payment of the owner's share of the cost out
19 of and only out of production from the well allocable to the owner's interest in the permanent spacing unit,
20 excluding royalty or other interest not obligated to pay any part of the cost and excluding the royalty provided for
21 in subsection (2)(c). If a well has not been drilled prior to the hearing on the application, the pooling order must
22 provide for the drilling and operating of a well on the permanent spacing unit and for the payment of the cost of
23 the well, which may include a reasonable charge for supervision, handling, and storage. If a dispute arises as to
24 the cost, the board by subsequent order, after notice and hearing, shall determine the proper cost. The order may
25 provide in substance that the owners who agree to share in the cost of drilling and operating the well are, unless
26 they agree otherwise, entitled to receive, subject to royalty or similar obligations, all of the production of the well
27 until they have recovered all of the costs out of the production. After all costs of drilling and operation are
28 recovered, all of the owners in the permanent spacing unit are entitled to receive their respective shares of the
29 production of the well as their interest may appear after deducting their respective shares of current operating
30 costs.

1 (b) If a well has been drilled prior to the hearing on the application and an owner, after written demand,
2 has failed or refused to pay the owner's share of the costs of development or other operations referred to in
3 subsection (1) or if a well has not been drilled prior to the hearing on the application and an owner refuses to
4 agree to pay the owner's share of drilling and completion costs, in addition to the costs under subsection (2)(a),
5 the order must include as costs:

6 (i) 100% of the refusing owner's share of the cost of newly acquired surface equipment beyond the
7 wellhead connections, including but not limited to stock tanks, separators, treaters, pumping equipment, and
8 piping, plus 100% of the refusing owner's share of the cost of operation of the well commencing with first
9 production and continuing until the agreeing owners have recovered the costs; and

10 (ii) 200% of the refusing owner's share of the costs and expenses of staking, well site preparation,
11 obtaining rights-of-way, rigging up, drilling, reworking, deepening or plugging back, testing, and completing the
12 well, after deducting any cash contributions received from the refusing owners by the agreeing owners, and 200%
13 of that portion of the cost of equipment in the well, including the wellhead connections.

14 (c) A refusing owner of an oil and gas interest in a spacing unit that is not subject to any lease or other
15 contract for development of oil and gas is considered to own a landowner royalty equal to one-eighth of the
16 owner's proportionate share of production from the well until such time as the consenting owners recover the
17 costs specified in subsection (2)(b). Any interest in production from the spacing unit to which the interest of the
18 refusing owner may be subject must be deducted from the royalty considered to be owned by the refusing owner.
19 After costs have been recovered by the agreeing owners, the refusing owner owns the refusing owner's
20 proportionate share of the well, surface facilities, and production and is liable for further costs as if the refusing
21 owner had originally agreed to drilling of the well.

22 (d) The operator of a well under a pooling order in which there is a refusing owner shall upon demand
23 furnish the refusing owner with a monthly statement of all costs incurred, together with the quantity of oil or gas
24 produced and the amount of proceeds realized from the sale of production during the preceding month.

25 (e) If an owner of an oil and gas interest in a temporary spacing unit refuses to agree to pay the owner's
26 share of the costs of drilling and operating a well drilled within the unit and an application is filed for pooling of
27 the interests in the well in a permanent spacing unit, the board shall, upon hearing the application for pooling of
28 the interests for the well, order that the parties who agreed to share in the cost of drilling and operating the well
29 prior to commencement of the drilling operation recover out of the refusing owner's share of the costs as provided
30 in subsections (2)(a) and (2)(b).

1 (3) (a) An owner is presumed to have refused to pay the owner's share of costs if prior to the spud date
2 of the well, the owner fails to pay or agree in writing to promptly pay the share of the costs after notice by the well
3 operator either:

4 (i) acknowledged in writing by the owner as received; or

5 (ii) sent at least 30 days prior to the spud date of the well to the owner by certified mail, addressed to the
6 owner's address of record in the office of the clerk and recorder of the county where the well is to be drilled or
7 to the owner's address on file with the board.

8 (b) The notice must set forth the location of the well, the projected depth and target formations, the
9 anticipated costs of drilling and completing the well, and the anticipated spud date of the well.

10 (4) The board shall give notice, as provided in 82-11-141, to the board of land commissioners of any
11 pooling arrangement under consideration that is adjacent to any state land or that is proposed to include any state
12 land."

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14 NEW SECTION. Section 7. Effective date. [This act] is effective July 1, 2009.

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16 NEW SECTION. Section 8. Applicability. [This act] applies to oil and gas leases entered into or
17 renewed on or after [the effective date of this act].

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