

BILL ANALYSIS

C.S.H.B. 2087
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Energy Resources
Committee Report (Substituted)

BACKGROUND AND PURPOSE

The development of shale formations in Texas is dominating the current and foreseeable future of the state's oil and gas industry. These shale drilling prospects are ideally developed by horizontal wells which are typically drilled on pooled units composed of multiple parcels of land in which there are commonly nonparticipating royalty interests (NPRIs) in one or more tracts. NPRIs are not formed by execution of a lease between a landowner-lessor (who retains a royalty) and the lessee. Rather, NPRIs are formed outside of a lease context and commonly occur when a land broker buys an oil and gas interest and retains a royalty interest of a few percent when the broker subsequently sells the interest. The number of NPRIs has greatly increased in recent years as a result of speculative buying and selling of oil and gas interests. An NPRI cannot be pooled into a unit unless the owner of the NPRI ratifies the lease or unit designation.

Under case law, an NPRI owner who has not consented to the pooling of its interest in a vertical well should be paid on a tract basis as if no unit designation is in effect, but there is little case law addressing the issue of how to account to the owner of an interest in a tract that is not subject to a pooled unit when a horizontal well is producing from multiple tracts. Many problems arise from this lack of guidance, for the most part related to sorting out commingling shares of production among multiple owners and disproportionate royalty payments, all of which delay drilling of the well. The lost opportunity for production is a detriment to the many other interest owners in the unit who want the well to be drilled and to the state in the form of lost severance tax revenue and economic activity.

C.S.H.B. 2087 addresses this lack of guidance by creating a presumption that the amount of oil and gas produced from a tract containing a non-pooled NPRI is proportional to the length of that part of the producing segment of the drainhole underlying the tract to the total length of the producing segment of drainhole, which would encourage the drilling of horizontal oil and gas wells by removing impediments to drilling. The goals of the bill to prevent waste, protect correlative rights of all property interest owners, and foster certainty in property interests. It is conjectured that NPRI owners whose interest has not been pooled will receive royalty on the amount of production attributed to their tracts with reasonable probability. The increase in production is likely to result in additional state severance tax revenue.

RULEMAKING AUTHORITY

It is the committee's opinion that this bill does not expressly grant any additional rulemaking authority to a state officer, department, agency, or institution.

ANALYSIS

C.S.H.B. 2087 amends the Natural Resources Code to entitle a payee who owns a nonparticipating royalty interest in a tract that has been penetrated by a horizontal drainhole well for oil or gas, or both, and who has not ratified a lease or pooling agreement covering the tract, to be paid the payee's allocated share of the proceeds derived from the sale of oil or gas production

from the well based on the ratio of the length of the portion of the horizontal drainhole between the first take point and last take point of the horizontal drainhole that crosses the tract in which the payee owns the nonparticipating royalty interest to the total length of the horizontal drainhole between the first take point and the last take point of the horizontal drainhole. The bill establishes that a payor who pays such a payee based on the allocation method set forth by the bill's provisions is presumed to have accurately attributed production to the payee's interest.

C.S.H.B. 2087 authorizes a payor or payee under the bill's provisions to rebut the presumption that the allocation method provided accurately attributes to the payee's nonparticipating royalty interest by obtaining a final order of the railroad commission establishing another method of allocation of production to the payee's interest. The bill authorizes the payor or payee to obtain such an order to be obtained only after application, notice to each payee owning an interest in the tract that is subject to the non-participating royalty interest and the payor, and an opportunity for hearing. The bill authorizes the Railroad Commission of Texas to establish an alternate method of allocation only upon showing by clear and convincing evidence that the alternate method is more accurate in attributing production to the payee's interest than the method set out by the bill's provisions. The bill establishes that the railroad commission has exclusive primary jurisdiction over such a determination.

C.S.H.B. 2087 makes its provisions inapplicable to units formed under the Mineral Interest Pooling Act or an interest owned by this state.

EFFECTIVE DATE

On passage, or, if the bill does not receive the necessary vote, September 1, 2011.

COMPARISON OF ORIGINAL AND SUBSTITUTE

C.S.H.B. 2087 contains a provision not included in the original making its provisions inapplicable to an interest owned by this state. The substitute differs from the original by making its provisions applicable only to the allocation of production from a horizontal drainhole oil or gas well that is spudded on or after the effective date of the substitute, whereas the original makes its provisions applicable only to production from wells spudded on or after September 1, 2011. The substitute differs from the original in nonsubstantive ways by using language reflective of certain bill drafting conventions and making clarifying changes.