

## **What is Integration?**

Oil and gas ownership, like that of other minerals, is a property right. As the owner of the oil and gas rights you have the right to explore for and produce those minerals. The purest expression of this ownership right, however, can produce oil and gas fields where every owner has drilled and is producing their own well. Pictures of the old oil fields in Texas with thousands of drilling derricks show the effect of ownership rights without regulations. Every owner is literally forced to drill a well to capture their share of the oil and gas beneath their lands. This leads to surface destruction because of the proliferation of unnecessary wells and the inefficient production of the oil and gas from over drilling. As a result, nearly every oil and gas producing state implemented regulations which limit the number of wells that can be drilled in a particular area. These regulations are known as spacing laws, or in New York they are called integration laws and they provide a means to form “units” which efficiently spaced wells and equitably split the oil and gas among the unit owners.

## **History of Integration in New York**

In the 1960’s New York drafted and passed its Integration Statute into law following the Interstate Oil and Gas Compact Commission’s model which is used in most oil and gas producing states. However, the drilling activity in New York over the years focused on shallow producing zones on small drilling units that did not require the “pooling of interests”. The result is that New York’s Integration Statute was rarely used or tested. That all changed when CNR, Fairman Drilling and Pennsylvania General began drilling deep Trenton Black River wells beginning in the late 1990’s. Trenton Black River wells are drilled to depths of around 10,000 feet and produce from areas or “units” containing anywhere from 300 to 700 acres. These units often require the “pooling” of multiple properties into the well or unit. Since the DEC has determined that one well can efficiently drain up to 640 acres, operators are required to space wells on roughly 640 acre units. If voluntary agreements are not reached among the owners of the oil and gas rights within the unit, then New York’s Integration Statute became applicable. A copy of the old Integration Statute can be found on this web site. Outside of New York it is a generally accepted principle that all owners have the right to “join” (participate in the drilling) in a well on a unit containing their lands or a portion of their lands. Most state regulatory bodies also require that an offer to share in the costs of a well be extended to an owner before an integration statute can be utilized, as integration statutes are intended to be used only where voluntary participation agreements cannot be reached. The integration statute then sets out the terms under which an uncooperative owner’s land can be integrated into a unit so as to allow the drilling of a well. Integration statutes typically apply a penalty against any owner who refuses, at the time the well is drilled, to share in the cost of the well. This is known as the risk penalty model. New York’s Statute is based on the risk penalty model and the original Integration Statute contained a 100% penalty for non-participation.

In the Wilson Hollow Field, Pennsylvania General applied for and the DEC began to convene integration proceedings under the old Integration Statute. In that hearing, PGE argued and the DEC ruled that interests not controlled by the Operator, (PGE in that case) were entitled to a 1/8<sup>th</sup> royalty only. This ruling meant that 7/8ths of an uncontrolled owners interest in gas produced from the spacing unit was confiscated by Order of the DEC and given to the Operator. Needless to say, that ruling had a devastating effect upon the rights of oil and gas interest owners in the State of New York. Operators could integrate owners they couldn't lease, or owners that had leased to others, for a 1/8<sup>th</sup> royalty only. Operators no longer had any incentive to pay higher royalties or higher signing bonuses once they had leased over 60% of a unit because the Operator would get the remaining 7/8ths interest at no cost. Operators seemingly quickly carved out operating areas and made deals with each other to make sure this law was not applied against them. Property owners in New York now had only one alternative, lease to the operator for whatever the operator was willing to pay, or have their interest Compulsorily Integrated at a 1/8<sup>th</sup> royalty.

In 2003, Western Land Services began a challenge of this practice by petitioning the DEC for a Declaratory Ruling asking whether an uncontrolled owner (an unleased party or a lessee other than the operator) has a right to their interest in production after payment of the penalty. While the answer in all other oil and gas producing states would be a clear and unequivocal yes, the DEC, after receiving 18 months of public comment and deliberation, determined that the owner "may" be "eligible" for their property interest in production, but such eligibility would be determined based on field specific facts developed at each unit hearing. WLS felt the Statute clearly gave an owner their full property interest after paying cost and a 100% cost penalty. As a result WLS instigated an Article 78 legal proceeding in Supreme Court (Albany County) challenging the DEC's Declaratory Ruling on the basis that the only penalty that may be levied against a non-consenting interest owner is the 100% of cost penalty, and any loss of interest in the property was a violation of the Constitutional prohibition against taking of property without compensation. WLS also argued that the DEC interpretation of the law was eliminating competition for leases and therefore reducing the value of lease terms being offered to landowners. Oil companies, who could not be assured that the property rights acquired under the terms of a lease would not be taken away under a DEC order, in most cases would not even attempt to buy a lease. While this certainly benefited existing operators; New York landowners, because of the lack of competition, were not realizing the full value of the mineral rights.

## **A New Integration Statute is Signed into Law**

At the same time as these legal issues were boiling to the surface, landowners were becoming increasingly frustrated with their treatment in the leasing process. They saw first hand how Operators had become emboldened by the DEC policy and the resulting lease negotiations were one-sided and sometimes hostile. The combination of the legal fighting and news stories of landowner discontent caused the

DEC to halt all integration proceedings and join WLS, Fortuna, CNR, the Independent Oil and Gas Association and New York Farm Bureau in asking the Legislature to re-write the New York Integration statute. A new Integration Statute (copy available on this web site) was introduced by Representative Bill Parment in the State Assembly and State Senator George Winner in the State Senate, and was signed into law and became effective in August of 2005. The new law is a clear victory for landowners as their mineral rights can no longer be taken without compensation. The new law provides all unleased owners with three statutory options.

- You may participate in the well by paying your share of wells costs at the conclusion of the Integration hearing.
- You may have your share of costs paid out of any production proceeds from the well. In which case, you will not only pay well costs but additionally the statutory penalty on those costs which range from 100% -200% of costs.
- You can elect to be a 1/8<sup>th</sup> royalty only owner. This is the same as leasing to the Operator at 1/8<sup>th</sup> royalty but without the benefit of any bonus payment or other consideration.

Because the new law recognizes your mineral rights as a property right and therefore grants you the right to participate in any well involving your property, there is a market for those rights. This gives you one additional option for your property which, in WLS' opinion, is the more attractive option for you. That is to lease to someone who will pay you for the lease, take over the responsibilities of paying the bills and at the same time pay you a share of production, perhaps greater than the 1/8<sup>th</sup> available in the statute.

This is the option countless landowners in the Southern tier have chosen. We hope you will consider this option for your property and contact a WLS representative to discuss possible lease terms.

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