An Act

ENROLLED HOUSE
BILL NO. 2654

By: Jordan, Billy and Cooksey
of the House

and

Johnson (Rob) and Shortey
of the Senate

An Act relating to oil and gas agreements; creating the Energy Litigation Reform Act; providing short title; providing rules of construction for certain agreements; providing exceptions; clarifying applicable terms for certain actions; limiting damages in certain actions for failure to pay proceeds; setting damages; amending 52 O.S. 2011, Section 87.1, which relates to common source for supply of oil; establishing results of certain election; providing for codification; and declaring an emergency.

SUBJECT: Oil and gas

BE IT ENACTED BY THE PEOPLE OF THE STATE OF OKLAHOMA:

SECTION 1. NEW LAW A new section of law to be codified in the Oklahoma Statutes as Section 901 of Title 52, unless there is created a duplication in numbering, reads as follows:

Sections 1 through 3 of this act shall be known and may be cited as the "Energy Litigation Reform Act".

SECTION 2. NEW LAW A new section of law to be codified in the Oklahoma Statutes as Section 902 of Title 52, unless there is created a duplication in numbering, reads as follows:

The sanctity of private agreements, and the consistent and predictable application and interpretation of statutes, governmental orders and common law, being essential to the oil and gas industry, the following are declared to be paramount rules of construction to

be applied by the courts of this state in the construction of private agreements, statutes and governmental orders relating to the exploration for, operations for, producing of, or marketing oil or gas, or disbursing proceeds of production of oil or gas:

1. A person is bound as a reasonably prudent operator to operate the well on behalf of all owners in the well and perform any duties owed to any person under a private agreement, statute, governmental order or common law relating to the exploration for, operations for, producing of, or marketing oil or gas, or disbursing proceeds of production of oil or gas, and performance of the duties described herein is that performance which an operator acting reasonably would have undertaken given the circumstances at the time, without being required to subordinate its own business interests, but with due regard to the interests of all affected parties, including the operator; and

2. There shall not be implied in the duties in paragraph 1 of this section or otherwise any fiduciary duty, quasi-fiduciary duty or other similar special relationship in any private agreement, statute or governmental order or common law relating to the exploration for, operations for, producing of, or marketing oil or gas, or disbursing proceeds of production of oil or gas.

Nothing in this section shall either prohibit the parties to a private agreement from expressly agreeing in writing otherwise or prohibit the Legislature from expressly providing otherwise in any statute subsequently enacted or prohibit any governmental order from expressly providing otherwise to the extent within the power or authority of the issuer of such order. However, the provisions of paragraph 2 of this section shall not apply to Sections 287.1 through 287.15 of Title 52 of the Oklahoma Statutes and nothing in this act shall be interpreted to relieve an operator or owner from any obligation or duty set forth expressly in the Production Revenue Standards Act or the Natural Gas Market Sharing Act; provided the performance of such obligations or duties shall be subject to the same reasonably prudent operator standard set forth in paragraph 1 of this section.

SECTION 3. NEW LAW A new section of law to be codified in the Oklahoma Statutes as Section 903 of Title 52, unless there is created a duplication in numbering, reads as follows:

Except for the right to enforce lien rights under private agreement or under Sections 548 through 549.12 of Title 52 of the

Oklahoma Statutes and except where specific remedies are provided by private agreement, and as long as paragraph 1 of subsection D of Section 570.10 of Title 52 of the Oklahoma Statutes provides for an interest rate equal to or greater than twelve percent (12%) compounded annually, the Production Revenue Standards Act shall provide the exclusive remedy to a person entitled to proceeds from production for failure of a holder to pay the proceeds within the time periods required for payment. The interest amounts set forth in subsection D of Section 570.10 and the remedies set forth in subsection C of Section 570.14 of Title 52 of the Oklahoma Statutes, with the term "actual damages" as used therein being limited to the proceeds due and the interest as provided in subsection D of Section 570.10 of Title 52 of the Oklahoma Statutes, are deemed to be adequate remedies for failure to pay proceeds within the time periods required for payment and no other penalty or damages shall be recoverable in any litigation involving a claim for unpaid or underpaid proceeds from production including, without limitation, punitive or exemplary damages or disgorgement damages, unless there shall be a determination by the finder of fact upon clear and convincing evidence that the holder who failed to pay such proceeds did so with the actual, knowing and willful intent: (a) to deceive the person to whom the proceeds were due, or (b) to deprive proceeds from the person the holder knows, or is aware, is legally entitled thereto.

SECTION 4. AMENDATORY 52 O.S. 2011, Section 87.1, is amended to read as follows:

Section 87.1. Whenever the production from any common source of supply of oil or natural gas in this state can be obtained only under conditions constituting waste or drainage not compensated by counterdrainage, then any person having the right to drill into and produce from such common source of supply may, except as otherwise authorized or in this section provided, take therefrom only such proportion of the oil or natural gas that may be produced therefrom without waste or without such drainage as the productive capacity of the well or wells of any such person considered with the acreage properly assignable to each such well bears to the total productive capacities of the wells in such common source of supply considered with the acreage properly assignable to each well therein.

(a) To prevent or to assist in preventing the various types of waste of oil or gas prohibited by statute, or any wastes, or to protect or assist in protecting the correlative rights of interested parties, the Corporation Commission, upon a proper application and

notice given as hereinafter provided, and after a hearing as provided in the notice, shall have the power to establish well spacing and drilling units of specified and approximately uniform size and shape covering any common source of supply, or prospective common source of supply, of oil or gas within the State of Oklahoma; provided, that the Commission may authorize the drilling of an additional well or wells on any spacing and drilling unit or units or any portion or portions thereof or may establish, reestablish, or reform well spacing and drilling units of different sizes and shapes when the Commission determines that a common source of supply contains predominantly oil underlying an area or areas and contains predominantly gas underlying a different area or areas; provided further that the units in the predominantly oil area or areas shall be of approximately uniform size and shape, and the units in the predominantly gas area or areas shall be of approximately uniform size and shape, except that the units in the gas area or areas may be of nonuniform size and shape when they adjoin the units in the oil area or areas; provided further that the drilling pattern for such nonuniform units need not be uniform, and provided further that the Commission shall adjust the allowable production within the common source of supply, or any part thereof, and take such other action as may be necessary to protect the rights of interested parties. Any order issued pursuant to the provisions hereof may be entered after a hearing upon the petition of any person owning an interest in the minerals in lands embraced within such common source of supply, or the right to drill a well for oil or gas on the lands embraced within such common source of supply, or on the petition of the Conservation Officer of the State of Oklahoma. When such a petition is filed with the Commission, the Commission shall give at least fifteen (15) days' notice of the hearing to be held upon such petition by one publication, at least fifteen (15) days prior to the hearing, in some newspaper of general circulation published in Oklahoma County, and by one publication, at least fifteen (15) days prior to the date of the hearing, in some newspaper published in the county, or in each county, if there be more than one, in which the lands embraced within the application are situated. Except as to the notice of hearing on such a petition, the procedural requirements of Section 86.1 et seq. of this title shall govern all proceedings and hearings provided for by this section.

(b) In case of a spacing unit of one hundred sixty (160) acres or more, no oil and/or gas leasehold interest outside the spacing unit involved may be held by production from the spacing unit more than ninety (90) days beyond expiration of the primary term of the lease.

(c) In establishing a well spacing or drilling unit for a common source of supply thereunder, the acreage to be embraced within each unit may include acreage from more than one governmental section, but shall not exceed six hundred forty (640) acres for a gas well plus ten percent (10%) tolerance, unless the unit is a governmental section and the governmental section contains more than six hundred forty (640) acres in which case the unit may comprise the entire section. Provided, however, fractional sections along the state boundary line and within the townships along the boundary where the survey west of the Indian Meridian meets the survey east of the Cimarron Meridian may be spaced with adjoining section unit, and the shape thereof shall be determined by the Commission from the evidence introduced at the hearing, and the following facts, among other things, shall be material: (1) The lands embraced in the actual or prospective common source of supply; (2) the plan of well spacing then being employed or contemplated in the source of supply; (3) the depth at which production from the common source of supply has been or is expected to be found; (4) the nature and character of the producing or prospective producing formation or formations; and (5) any other available geological or scientific data pertaining to the actual or prospective source of supply which may be of probative value to the Commission in determining the proper spacing and well drilling unit therefor, with due and relative allowance for the correlative rights and obligations of the producers and royalty owners interested therein.

The order establishing such spacing or drilling units shall set forth: (1) the outside boundaries of the surface area included in such order; (2) the size, form, and shape of the spacing or drilling units so established; (3) the drilling pattern for the area, which shall be uniform except as hereinbefore provided; and (4) the location of the permitted well on each such spacing or drilling unit. To such order shall be attached a plat upon which shall be indicated the foregoing information. Subject to other provisions of Section 86.1 et seq. of this title, the order establishing such spacing or drilling units shall direct that no more than one well shall thereafter be produced from the common source of supply on any unit so established, and that the well permitted on that unit shall be drilled at the location thereon as prescribed by the Commission, with such exception as may be reasonably necessary where it is shown, upon application, notice and hearing in conformity with the procedural requirements of Section 86.1 et seq. of this title, and the Commission finds that any such spacing unit is located on the edge of a pool and adjacent to a producing unit, or for some other reason that to require the drilling of a well at the prescribed

location on such spacing unit would be inequitable or unreasonable. Whenever such an exception is granted, the Commission shall adjust the allowable production for the spacing unit and take such other action as may be necessary to protect the rights of interested parties.

Any well spacing or drilling unit for a common source of supply thereunder which exceeds six hundred forty (640) acres for a gas well plus ten percent (10%) tolerance or exceeds the total amount of acreage contained in a governmental section, and is not in production or in the process of drilling development on the effective date of this act shall be de-spaced. However, fractional sections along the state boundary line and within the townships along the boundary where the survey west of the Indian Meridian meets the survey east of the Cimarron Meridian may be spaced with adjoining section unit, and the shape thereof shall be determined by the Commission.

(d) The Commission shall have jurisdiction upon the filing of a proper application therefor, and upon notice given as provided in subsection (a) of this section, to decrease the size of the well spacing units or to permit additional wells to be drilled within the established units, or to increase the size or modify the shape of the well spacing units, upon proper proof at such hearing that such modification or extension of the order establishing drilling or spacing units will prevent or assist in preventing the various types of wastes prohibited by statute, or any of the wastes, or will protect or assist in protecting the correlative rights of persons interested in the common source of supply, or upon the filing of a proper application therefor to enlarge the area covered by the spacing order, if such proof discloses that the development or the trend of development indicates that such common source of supply underlies an area not covered by the spacing order and such proof discloses that the applicant is an owner within the area or within a drilling and spacing unit contiguous to the area covered by the application. Except in the instance of reservoir dewatering as described herein, the Commission shall not establish well spacing units of more than forty (40) acres in size covering common sources of supply of oil, the top of which lies less than four thousand (4,000) feet below the surface as determined by the original or discovery well in the common source of supply, and the Commission shall not establish well spacing units of more than eighty (80) acres in size covering common sources of supply of oil, the top of which lies less than nine thousand nine hundred ninety (9,990) feet and more than four thousand (4,000) feet below the surface as

determined by the original or discovery well in the common source of supply. In the instance of reservoir dewatering to extract oil from reservoirs having initial water saturations at or above fifty percent (50%), the Commission may establish drilling and spacing units not to exceed six hundred forty (640) acres in size.

(e) The drilling of any well or wells into any common source of supply for the purpose of producing oil or gas therefrom, after a spacing order has been entered by the Commission covering such common source of supply, at a location other than that fixed by the order is hereby prohibited. The drilling of any well or wells into a common source of supply, covered by a pending spacing application, at a location other than that approved by a special order of the Commission authorizing the drilling of such well is hereby prohibited. The operation of any well drilled in violation of any spacing so entered is also hereby prohibited. When two or more separately owned tracts of land are embraced within an established spacing unit, or where there are undivided interests separately owned, or both such separately owned tracts and undivided interests embraced within such established spacing unit, the owners thereof may validly pool their interests and develop their lands as a unit. Where, however, such owners have not agreed to pool their interests and where one such separate owner has drilled or proposes to drill a well on the unit to the common source of supply, the Commission, to avoid the drilling of unnecessary wells, or to protect correlative rights, shall, upon a proper application therefor and a hearing thereon, require such owners to pool and develop their lands in the spacing unit as a unit. The applicant shall give all the owners whose addresses are known or could be known through the exercise of due diligence at least fifteen (15) days' notice by mail, return receipt requested. The applicant shall also give notice by one publication, at least fifteen (15) days prior to the hearing, in some newspaper of general circulation published in Oklahoma County, and by one publication, at least fifteen (15) days prior to the date of the hearing, in some newspaper published in the county, or in each county, if there be more than one, in which the lands embraced within the spacing unit are situated. The applicant shall file proof of publication and an affidavit of mailing with the Commission prior to the hearing. All orders requiring such pooling shall be made after notice and hearing, and shall be upon such terms and conditions as are just and reasonable and will afford to the owner of such tract in the unit the opportunity to recover or receive without unnecessary expense the owner's just and fair share of the oil and gas. The portion of the production allocated to the owner of each tract or interests included in a well spacing unit formed by

a pooling order shall, when produced, be considered as if produced by such owner from the separately owned tract or interest by a well drilled thereon. Such pooling order of the Commission shall make definite provisions for the payment of cost of the development and operation, which shall be limited to the actual expenditures required for such purpose not in excess of what are reasonable, including a reasonable charge for supervision. In the event of any dispute relative to such costs, the Commission shall determine the proper costs after due notice to interested parties and a hearing thereon. The operator of such unit, in addition to any other right provided by the pooling order or orders of the Commission, shall have a lien on the mineral leasehold estate or rights owned by the other owners therein and upon their shares of the production from such unit to the extent that costs incurred in the development and operation upon the unit are a charge against such interest by order of the Commission or by operation of law. Such liens shall be separable as to each separate owner within such unit, and shall remain liens until the owner or owners drilling or operating the well have been paid the amount due under the terms of the pooling order. The Commission is specifically authorized to provide that the owner or owners drilling, or paying for the drilling, or for the operation of a well for the benefit of all shall be entitled to production from such well which would be received by the owner or owners for whose benefit the well was drilled or operated, after payment of royalty, until the owner or owners drilling or operating the well have been paid the amount due under the terms of the pooling order or order settling such dispute. No part of the production or proceeds accruing to any owner of a separate interest in such unit shall be applied toward payment of any cost properly chargeable to any other interest in the unit.

For the purpose of this section, the owner or owners of oil and gas rights in and under an unleased tract of land shall be regarded as a lessee to the extent of a seven-eighths (7/8) interest in and to the rights and a lessor to the extent of the remaining one-eighth (1/8) interest therein, unless and until the owner or owners make an election or are deemed to make an election not to participate under a pooling order issued by the Commission, at which time each such owner shall be considered a lessor, subject to the judicially recognized implied covenant to market found to exist by the courts of this state in oil and gas leases covering lands located in this state, to the extent of the full royalty percentage elected under the pooling order. Should the owners of separate tracts or interests embraced within a spacing unit fail to agree upon a pooling of their interests and the drilling of a well on the unit,

and should it be established by final, unappealable judgment of a court of competent jurisdiction that the Commission is without authority to require pooling as provided for herein, then, subject to all other applicable provisions of this act, the owner of each tract or interest embraced within a spacing unit may drill on his or her separately owned tract, and the allowable production therefrom shall be that portion of the allowable for the full spacing unit as the area of such separately owned tract bears to the full spacing unit.

In the event a producing well or wells are completed upon a unit where there are, or may thereafter be, two or more separately owned tracts, each royalty interest owner shall share in all production from the well or wells drilled within the unit, or in the gas well rental provided for in the lease covering such separately owned tract or interest in lieu of the customary fixed royalty, to the extent of such royalty interest owner's interest in the unit. Each royalty interest owner's interest in the unit shall be defined as the percentage of royalty owned in each separate tract by the royalty owner, multiplied by the proportion that the acreage in each separately owned tract or interest bears to the entire acreage of the unit.

(f) Notwithstanding any provision of this section to the contrary, the Corporation Commission shall have jurisdiction upon the filing of a proper application therefor, and upon notice given as provided in subsection (a) of this section, to establish spacing rules for horizontally drilled oil wells whereby horizontally drilled oil wells may have well spacing units established of up to six hundred forty (640) acres plus tolerances and variances as allowed for gas wells pursuant to subsection (c) of this section. For purposes of this subsection a "horizontally drilled oil well" shall mean an oil well drilled, completed or recompleted in a manner in which the horizontal component of the completion interval in the geological formation exceeds the vertical component thereof and which horizontal component extends a minimum of one hundred fifty (150) feet in the formation. The Corporation Commission shall promulgate rules necessary for the proper administration of this subsection.

SECTION 5. It being immediately necessary for the preservation of the public peace, health and safety, an emergency is hereby declared to exist, by reason whereof this act shall take effect and be in full force from and after its passage and approval.

Passed the House of Representatives the 1st day of May, 2012.

Presiding Officer of the House
of Representatives

Passed the Senate the 16th day of April, 2012.

Presiding Officer of the Senate

OFFICE OF THE GOVERNOR

Received by the Governor this 3rd

day of May, **20** 12,

at 3:20 **o'clock** PM.

By: Jennie B Byers

Approved by the Governor of the State of Oklahoma the 8th **day of**

May, **20** 12, **at** 12:03 **o'clock** PM.

Governor of the State of Oklahoma

OFFICE OF THE SECRETARY OF STATE

Received by the Secretary of State this

8th **day of** May, **20** 12,

at 1:33 **o'clock** P **M.**

By: Michelle R Day