§ 23-0901. Compulsory integration and unitization in oil and natural gas pools and fields.

1. Compulsory integration and unitization in oil pools and fields and in natural gas pools and fields shall be subject to the provisions of this section with subdivision 3 to be specifically applicable to integration within individual spacing units, and subdivisions 4 through 12 to be specifically applicable to unit operation of an entire pool or part thereof.

2. The department shall not make any order requiring the integration of interests in any spacing unit or requiring the development or operation of any field, pool or part thereof as a unit unless it finds, after detailed study and analysis, notice and hearing, that the integration of interests in spacing units, under conditions then existing in this state, or in the field or pool to be affected, is necessary to carry out the policy provisions of section 23-0301 of this article.

3. In the absence of voluntary integration as permitted by section 23-0701 of this article and after finding as required by subdivision 2 of this section, the department shall make an order integrating all tracts or interests in the spacing unit for development and operation. Each such integration order shall be upon terms and conditions that are just and reasonable and subject to the following:

a. As used in this section or otherwise in this article, to the extent applicable to oil and gas wells:

(1) "Integrated non-participating owner" or "non-participating owner" means an owner who elects to reimburse the well operator, out of production proceeds, for such owner's proportionate share of the actual well costs of the initial well in a spacing unit and be subject to a risk penalty, and complies with all of the requirements for integration, including the terms of integration, as specified in an order of integration issued pursuant to the compulsory integration provisions of this section. The non-participating owner shall receive the full share of production attributable to such owner's proportionate interest in the

spacing unit following the recoupment by the well operator of the owner's proportionate share of the actual well costs plus a risk penalty of two hundred percent of the share of the actual well costs allocable to such owner. In the case of a leased tract, a royalty shall be deducted from the non-participating owner's share of production, which shall not be subject to charges or costs, but shall be separately calculated and paid to the non-participating owner on behalf of the royalty owner as follows:

(i) During the recovery of the actual well costs, 1/16 or 6.25%,

(ii) During the recovery of the first 100% of the risk penalty, 3/32 or 9.38%,

(iii) During the recovery of the second 100% of the risk penalty, the lowest royalty fraction set forth in an existing lease in the unit, but no less than 1/8 or 12.5%.

Nothing in this subparagraph relieves any lessee of its obligation to pay, from the commencement of production, any remaining royalty and overriding royalty owed under the terms of its lease.

(2) "Integrated participating owner" or "participating owner" means an owner who elects to participate in the initial well in a spacing unit, pays all costs associated with participation and complies with all of the requirements for participation, including the terms of integration, specified in an order of integration issued pursuant to the compulsory integration provisions of this section.

(3) "Integrated royalty owner" means an owner who has either elected to be an integrated royalty owner or who does not elect to become either a participating owner or a non-participating owner. The integrated royalty owner shall receive a royalty equal to the lowest royalty in an existing lease in the spacing unit, but no less than one-eighth. The integrated royalty owner shall have no obligation to the well operator or any other owner for any charges, taxes or fees associated with the operation of the oil or gas well and, notwithstanding any other law to the contrary, shall not be liable by reason of the owner's status as an integrated royalty owner for any claims for personal injury or property damage suffered by any person relating to the drilling and operation of the well.

(4) "Risk penalty" means the percentage applied to well costs to

reimburse the well operator for the risk involved with the exploration for and development of a well or the percentage applied to other costs that are subject to recoupment and a risk penalty, as provided herein. At any time during a risk penalty phase, an owner subject to a risk penalty may pay to the well operator the full amount subject to recoupment by the well operator, to terminate the risk penalty phase and be eligible for other opportunities for participation as provided herein.

(5) "Well costs" means the costs incurred or estimated to be incurred by the well operator in relation to the drilling, completion, and the installation of surface equipment, other than as described in item E of clause (ii) of subparagraph 1 of paragraph c of this subdivision, including, without limitation, surveying, drill site preparation, leasing of surface rights and access roads pertinent to the drill site, construction of access roads, permitting, drilling, stimulation, testing, well logging, drilling insurance, plugging and abandonment of the well, environmental mitigation costs associated with drilling and any other costs associated with the foregoing that the operator has incurred or anticipates incurring, including a reasonable charge for supervision of the foregoing activities.

b. If upon issuance of a well permit by the department, the well operator does not control all owners within the spacing unit, either through lease or voluntary agreement, the department shall schedule an integration hearing.

c. The well operator shall, no later than thirty days prior to the date of the integration hearing scheduled by the department, provide actual notice of the hearing to all uncontrolled owners wholly or partially within the spacing unit and shall provide notice by publication in a form and manner prescribed by the department. Prior to or contemporaneously with such notice, the well operator shall provide to the department the well operator's estimate of those well costs that the owners electing to participate shall be required to pay to the well operator prior to or at the integration hearing based on each owner's proportionate share of such costs and a list of each tract wholly or partially within the spacing unit, the acreage attributable thereto, the

percentage interest of the total spacing unit of each tract, an indication of whether the tract is controlled by the well operator and the names and addresses of the uncontrolled owners. If applicable, such list shall also identify each tract where the owners remain unknown or cannot be located after diligent efforts by the well operator. To the extent an owner cannot be determined after diligent efforts by the well operator and such owner is integrated as an integrated royalty owner, the well operator shall hold the royalty percentage payable to such integrated royalty owner in an interest bearing account for such integrated royalty owner until the owner is located or the property is deemed abandoned, whichever comes first.

(1) The notice of hearing to each uncontrolled owner shall be made in a form prescribed by the department, and shall include:

(i) An election form, as prescribed by the department, granting the uncontrolled owner the right to elect to be integrated into the spacing unit as an integrated participating owner, an integrated non-participating owner or an integrated royalty owner. Such form shall set forth the well operator's good faith estimate of those well costs which the owners electing to be integrated as participating owners will be responsible for paying to the well operator prior to conclusion of the integration hearing, based on each owner's proportionate share of such costs, and confirm that if an uncontrolled owner does not make a timely election and does not timely comply with all of the requirements to be either a participating owner or a non-participating owner, that such uncontrolled owner shall be integrated into the spacing unit as an integrated royalty owner.

(ii) A copy of the proposed order of integration, which shall include the proposed terms of integration applicable to integrated participating owners and integrated non-participating owners. The proposed order of integration shall include the following terms in addition to any applicable risk penalty:

A. The owner shall be liable for its proportionate share of all costs and expenses, including taxes, and claims of third parties related to the well, operations thereon and in conjunction therewith, and shall be entitled to its proportionate share of all benefits therefrom. If an owner's share of production is subject to a risk penalty, the well

operator shall establish a risk penalty account for such owner and all costs, expenses and benefits attributable to such owner shall be reflected in the penalty account;

B. The well operator shall hold any funds paid by the owner or recouped through the risk penalty attributable to the plugging and abandonment costs of the well, as estimated prior to the drilling of the well, in an interest bearing account until such funds are required and utilized for such purpose;

C. The owner shall be liable for and shall indemnify all other persons participating in the development of the well, whether participating owners, non-participating owners or otherwise, including the well operator, from and against all claims arising out of the owner's non-payment of rentals, royalties and other payments or burdens on the oil and gas rights that such owner contributes to the spacing unit and from and against all claims associated with the loss or failure of title to the oil and gas rights the owner contributes to the spacing unit;

D. The well operator shall have a first lien on the production of the owner to pay any outstanding costs, expenses or claims and the well operator shall be entitled to withhold and retain for the purposes of set off any revenue or production owed or due to the owner under an order of integration. Nothing in this paragraph shall affect the well operator's right to collect any outstanding amounts incurred nor the right of any fee owner of oil and gas interests to collect any amounts owed under the terms of any lease from such owner. The exercise of any remedy shall not preclude the well operator from seeking any other remedies available under the law;

E. Whether or not the owner is subject to a risk penalty, the well operator shall submit to the owner a written authority for expenditure of the estimated costs associated with the construction of any facilities not included in well costs beyond the surface equipment at the wellhead to the first point of interconnection with other facilities that commingle production from a group of wells that includes the well, including, but not limited to, pipe, compression, processing, treating,

dehydrating or separating equipment, fixtures, related buildings and other equipment. The owner shall have thirty days to elect to participate and pay its proportionate share of such estimated cost, the failure of which shall be deemed to be an election by the owner not to participate. If the owner elects not to participate or is deemed to have elected not to participate, the well operator shall be entitled to retain for its own account all of the owner's share of production from the well until the well operator has recouped from the net proceeds of the owner's share of production the owner's share of the actual costs of the facilities, plus a risk penalty of one hundred percent of such costs. Any such amounts shall be added to the risk penalty account for such owner;

F. If the owner is not subject to a risk penalty, the owner shall have the right to take its share of gas or oil production in kind and shall be responsible for its transportation and marketing arrangements downstream of the facilities constructed pursuant to item E of this clause. The owner's election to take in kind must be conveyed to the well operator no later than fourteen days prior to first production from the well or upon seventy-five days written notice to well operator at any time following first production from the well subject to the expiration of any existing contracts;

G. If the owner is not subject to a risk penalty and does not take its share of gas or oil production in kind, the well operator shall market the owner's share of production from the well ratably with its own share of production from the well for the account of the owner. The well operator shall pay the owner based on the price received by the well operator for production in the general area less (I) the owner's proportionate share of all costs incurred by the well operator for transporting, treating, processing, or otherwise making the production marketable, and (II) a marketing fee not to exceed five percent of the sales price of the production;

H. The well operator shall be entitled to propose and conduct a subsequent operation on a well, meaning any reworking, sidetracking, deepening, re-completing or plugging back of the well or the drilling of

a lateral or an infill well in the formation for which the unit was created. Owners shall be provided with a written authorization for expenditure of the estimated costs of the subsequent operation. An owner shall not be entitled to participate in a subsequent operation as long as the owner is in a risk penalty phase. If a subsequent operation is proposed while an owner is in a risk penalty phase, the owner's proportionate share of the actual cost of the subsequent operation plus two hundred percent of such actual costs shall be added to the risk penalty account for such owner. The owner not in a risk penalty phase shall have thirty days to elect and pay its proportionate share of the estimated costs, unless a drilling rig is on location, in which event notice of a subsequent operation may be given by telephone and the owner shall have forty-eight hours, exclusive of Saturday, Sunday and legal holidays, to make an election and thirty days to pay the owner's proportionate share of costs. The failure of any such owner to elect and pay in a timely manner shall be deemed an election by the owner not to participate in the subsequent operation. If such owner elects or is deemed to have elected not to participate in the subsequent operation, the well operator shall be entitled to retain all of the owner's proportionate share of production from the well until the well operator has recouped the proportionate share of the actual costs of the subsequent operation attributable to such owner, plus two hundred percent of such actual costs;

I. The well operator, on behalf of the owner, shall be entitled to conduct all acts associated with the well and necessary facilities related thereto, including without limitation: conducting title examination and curative work on the tracts included in the spacing unit; arranging for contract services or employees of the well operator, at the customary salaries, wages and benefits of such employees, to oversee the operation and maintenance of the well and the facilities in the production unit associated with the well; arranging for and maintaining required financial security for well bonds and insurance; discharging litigation, claims of third parties and disputing tax assessments; developing and implementing emergency responses and dealing with catastrophic events; and arranging for the storage, transporting and disposal of produced water, by-products or refuse associated with

production and maintenance facilities; and

J. Other terms may be included in the order of integration if the department determines such terms are reasonably required to further the policy objectives of section 23-0301 of this article.

(2) Within twenty-one days of receiving notice of the integration hearing, each uncontrolled owner shall provide to the well operator and the department its election as to whether it chooses to be integrated as a participating owner, a non-participating owner or an integrated royalty owner. Failure of an uncontrolled owner to elect to be integrated as a participating owner, a non-participating owner or an integrated royalty owner and to pay the amount specified in the notice by the date of the hearing, or to make any election, shall result in the owner being integrated as an integrated royalty owner. Nothing contained in this section shall preclude any person from entering into a lease or other voluntary agreement at any time prior to the hearing.

d. If substantive and significant issues are raised during the integration hearing, the department shall schedule an adjudicatory hearing.

e. If no substantive and significant issues are raised at the hearing, the department shall issue a final order of integration confirming the status of all uncontrolled owners in the spacing unit as participating owners, non-participating owners or integrated royalty owners; the terms of integration; the acreage attributable to each owner and the proportion such acreage bears to the entire spacing unit; and the royalty applicable to each integrated royalty owner. Such order shall be recorded by the well operator in the office of the county clerk in the county or counties where the spacing unit is wholly or partially located and such order shall be final and binding upon the well operator, all owners and their heirs, successors and assigns.

f. All operations including, but not limited to, the commencement, drilling, or operation of a well or the existence of a shut-in well upon any portion of a spacing unit covered by an order of integration shall be deemed for all purposes the conduct of such operations upon each

separately owned tract in the spacing unit by the owner or several owners thereof. That portion of the production allocated to each tract included in a spacing unit covered by an order of integration shall, when produced, be deemed for all purposes to have been produced from such tract by a well drilled thereon.

4. The department upon its own motion may, and upon the application of any interested person shall, hold a hearing to consider the need for the operation as a unit of an entire pool or part thereof.

5. The department shall make an order providing for the unit operation of a pool or part thereof if it finds that such operation is reasonably necessary to increase substantially the ultimate recovery of oil and gas, and the value of the estimated additional recovery of oil or gas exceeds the estimated additional cost incident to conducting such operation. The order shall be upon terms and conditions that are just and reasonable and shall prescribe a plan for unit operations that shall include:

a. A description of the unitized area, termed the unit area.

b. A statement of the nature of the operations contemplated.

c. An allocation to the separately owned tracts in the unit area of all the oil and gas that is produced from the unit area and is saved, being the production that is not used in the conduct of operations on the unit area or not unavoidably lost. The allocation shall be in accord with the agreement, if any, of the interested parties. If there is no such agreement, the department shall determine the value, from evidence introduced at the hearing, of each separately owned tract in the unit area, exclusive of physical equipment, for development of oil and gas by unit operations, and the production allocated to each tract shall be the proportion that the value of each tract so determined bears to the value of all tracts in the unit area.

d. A provision for the credits and charges to be made in the adjustment among the owners in the unit area for their respective

investments in wells, tanks, pumps, machinery, materials, and equipment contributed to the unit operations.

e. A provision providing how the expenses of unit operations, including capital investment, shall be determined and charged to the separately owned tracts and how said expenses shall be paid.

f. A provision, if necessary, for carrying or otherwise financing any person who is unable to meet his financial obligations in connection with the unit, allowing a reasonable interest charge for such service.

g. A provision for the supervision and conduct of the unit operations, in respect to which each person shall have a vote with a value corresponding to the percentage of the expenses of unit operations chargeable against the interest of such person.

h. The time when the unit operations shall commence, and the manner in which, and the circumstances under which, the unit operations shall terminate.

i. Such additional provisions as are found to be appropriate for carrying on the unit operations, and for the protection or adjustment of correlative rights.

6. No order of the department providing for unit operations shall become effective unless and until the plan for unit operations prescribed by the department has been approved in writing by the owners of sixty percent or more in interest as the costs of such unit operations are shared under the order of the department, and by owners of record of a like percentage of a one-eighth royalty interest in and to the unit area, and the department has made a finding, either in the order providing for unit operations, or in a supplemental order, that the plan for unit operations has been so approved by the required number of owners and royalty owners. If the plan for unit operations has not been so approved by owners and royalty owners at the time the order providing for unit operations is made, the department shall upon application and notice hold such supplemental hearings as may be

required to determine if and when the plan for unit operations has been so approved. If the owners and royalty owners, or either, owning the required percentage of interest in the unit area do not approve the plan for unit operations within a period of six months from the date on which the order providing for unit operations is made, such order shall cease to be of force and shall be revoked by the department.

7. An order providing for unit operations may be amended by an order made by the department, in the same manner and subject to the same conditions as an original order providing for unit operations, provided

a. if such an amendment affects only the rights and interests of the owners, the approval of the amendment by the royalty owners shall not be required, and

b. no such order of amendment shall change the percentage for allocation of oil and gas as established for any separately owned tract by the original order, except with the consent of all persons owning interest in such tract.

8. The department, by an order, may provide for the unit operation of a pool or a part thereof that embraces a unit area established by a previous order of the department. Such order, in providing for the allocation of unit production, shall first treat the unit area previously established as a single tract, and the portion of the unit production so allocated thereto shall then be allocated among the separately owned tracts included in such previously established unit area in the same proportions as those specified in the previous order.

9. Oil and gas allocated to a separately owned tract shall be deemed, for all purposes, to have been actually produced from such tract, and all operations, including, but not limited to, the commencement, drilling, or operation of a well upon any portion of the unit area shall be deemed for all purposes the conduct of such operations upon each separately owned tract in the unit area by its several owners. The operations conducted pursuant to the order of the department shall constitute a fulfillment of all the express or implied obligations of

each lease or contract covering lands in the unit area to the extent that compliance with such obligations cannot be had because of the order of the department.

10. Oil and gas allocated to any tract, and the proceeds from the sale thereof, shall be the property and income of the several persons to whom, or to whose credit, the same are allocated or payable under the order providing for unit operations.

11. No division order or other contract relating to the sale or purchase of production from a separately owned tract shall be terminated by the order providing for unit operations, but shall remain in force and apply to oil and gas allocated to such tract until terminated in accordance with the provisions thereof.

12. Except to the extent that the parties affected so agree, no order providing for unit operations shall be construed to result in a transfer of all or any part of the title of any person to the oil and gas rights in any tract in the unit area. All property, whether real or personal, that may be acquired in the conduct of unit operations hereunder shall be acquired for the account of the owners within the unit area, and shall be the property of such owners in the proportion that the expenses of unit operations are charged.

13. Any person taking title by operation of law to any oil and gas interests integrated into a spacing unit pursuant to an order of integration, shall take such interests subject to the terms and conditions of the final order of integration issued by the department duly recorded in accordance with the provisions of this section and shall be subject to all liabilities and benefits associated therewith, unless such person, within sixty days of the taking of such interest, elects to be an integrated royalty owner and notifies the well operator of such election.