

Whew indeed, quite a Friday afternoon memorandum.

Fortunately we have a Bureau policy here that forbids the reading of such memoranda on any day that will be followed by an ordinarily scheduled day off. And given that Mr. Buslee and I normally and ordinarily schedule a day off every other day, it appears that you may be out of luck in terms of an answer. That would be the lawyers Catch-22. We love it.

Nonetheless, and although I am up to my ears in a couple briefs, I grudgingly offer the following:

Attached is a memo I did for Jack King back in 2006.

This memo was intended to be a very general introduction [no actual case cites] but there was no requested follow-up and the Board did not decide to consider any changes [as I recall] but to continue with questioning any forced pooling applicants fairly closely as to the efforts taken to actually locate folks.

I'd also take a look at the early memorandum written by Garrity & Wilson; and I assume you have a copy of it.

Looking at 82-11-202:

The salient language in 82-11-202 (b) is that *"The Board upon application of an interested person may enter an order pooling all interests.....if the applicant has made an **unsuccessful, good faith attempt** to voluntarily pool..."* This highlighted area contains very key language that I believe applies to your questions, but I would like to address it at the end of this email.

While the statute uses the term "an interested person", it goes then goes on to define who can make an application, which you did not ask so I won't address it.

It further states: *"The pooling order **must** be made after a hearing....."*

This does not mean the pooling order is mandatory, simply that if the Board issues one, it can only do so after an appropriate hearing. Again, the discretion to issue a pooling order rests with the Board.

The statute also appears to allow the Board to decide the terms of the pooling order: *"...and must be upon terms that are just and reasonable, etc....."* While "just and reasonable" might be considered to give the Board some latitude, the "just and reasonable" phrase only applies to the terms of an issued order.

The statute goes on with eye crossing detail which [I think] references what sort of parameters surround just and reasonable.

As to each "owner" who "refuses" to pay an owner's share of the cost – 82-11-202 (2) (a) – the word owner is apparently now equivalent to the former language in subsection (1) (b) that referred to an interest holder.

You are correct [if not in your numbering] that 82-11-202 (2) (a) requires that the order "must provide" for the payment of the owner's share of the cost [apparently of drilling the well].

Cost is not particularly well defined, but in that same subsection, if there is a dispute over the "cost", the Board, after notice and hearing, gets to decide what it is.

82-11-202 (2) (b) gets to the meat of your questions.

You are correct about the 100% and 200% numbers being statutorily mandated, but they only come into play under the circumstances described in 82-11-202 (2) (b). The key words are if the owner, on a well already drilled "*has failed or refused*" to pay his share, or if the well has not been drilled, if he "*refuses to pay the owner's share of*" a defined level of costs. Again, costs may ultimately be a question for the board, but the 100% and 200% are statutory requirements of various specifically defined costs.

I don't think you asked about 82-11-202 (2) (c) (d) or (e).

The big question is what constitutes "refusal" of "failed".

The "refusal" question is easy. There is a statutory presumption, heavily in favor of the applicant and the overriding right to get at and produce oil and gas. A presumption that I find interesting in that it is being imposed against a mineral interest owner of that oil and gas, but that is neither here nor there.

The statute says that "refusal" is presumed if the owner "fails to pay or agree in writing to promptly pay" his share of the costs after notice by the well operator [who presumably may be different than the applicant for the order] that is either acknowledged by the owner to have been received or sent w/i 30 days prior to the spud date to the address of record in the County or at the office of the Board. The notice has to give an estimated cost of drilling and completion of the well.

So, there is no wiggle room in that statute regarding what "refusal" means, at least in terms of a presumption. The only wiggle room might be for that interest owner who may be negotiating costs; and there is then a dispute, and s/he would not be deemed to refuse to pay until such time as the Board finally determines what the costs may be.

But, we do now go back to the key language of "*if the applicant has made an unsuccessful, good faith attempt to voluntarily pool*".

It seems to me that the Board could make a good argument that not making reasonable efforts [in the eyes of the Board] to find a mineral owner might not constitute a good faith attempt to voluntarily pool said interests.

While the presumption of "refusal to pay" might be statutory, as are the 100% and 200% figures, the Board still has the overriding authority expressed at the beginning of the Statute. It "may" enter a pooling order, and it "may" only do so if the Board finds the applicant has made an "unsuccessful good faith attempt to voluntarily pool" all interests in the permanent spacing unit.

Just some thoughts to chew on.

82-1-301. Definition. The word "person", as used in this part, shall mean any individual, corporation, partnership, joint venture, trust or other entity capable of owning real property in Montana.

History: En. Sec. 6, Ch. 513, L. 1979.

82-1-302. Creation of trust for unlocatable mineral, leasehold, or royalty interest owners. (1) Any person who owns an interest in minerals underlying a tract of land may petition the district court of the county in which the tract or a portion of the tract is located to declare a trust in favor of other persons also owning or claiming an interest in the minerals underlying the tract if their place of residence and present whereabouts is unknown and cannot reasonably be ascertained.

(2) In requesting the appointment of a trustee, the petitioner shall show that:

(a) a diligent but unsuccessful effort to locate the absent owner or claimant has been made; and

(b) appointment of a trustee will be in the best interest of all owners of an interest in the minerals.

(3) After determining that the conditions of subsection (2) have been met, the court shall appoint the clerk of court or, if the clerk of court declines to act as trustee, the department of revenue as trustee and shall authorize the clerk of court or the department to execute and deliver an oil, gas, or other mineral lease, a ratification, a division order, or any other related document or instrument on the terms and conditions as the court may approve.

(4) If at any time a clerk of court decides to not continue as trustee for a trust for unlocatable mineral, leasehold, or royalty interest owners, the district court shall appoint the department of revenue to act as trustee. Upon the department of revenue's appointment as trustee, the clerk of court shall remit all funds and interest held in the trust to the department of revenue.

History: En. Sec. 1, Ch. 513, L. 1979; amd. Sec. 1, Ch. 126, L. 1997.

82-1-303. No further liability for petitioner. If a trust in favor of unlocatable owners or claimants of an interest in minerals has been created and all bonuses, rental payments, royalties, and other income due to the unlocatable owners are being or have been paid to the trustee, the person petitioning for creation of the trust is not liable for further claims by unlocatable owners for bonuses, rental payments, royalties, and other income produced after the creation of the trust.

History: En. Sec. 2, Ch. 513, L. 1979; amd. Sec. 190, Ch. 575, L. 1981.

82-1-304. Administration of trust. (1) The administration of the trust must comply with the appropriate provisions regulating trusts contained in Title 72.

(2) Trustee or attorney fees may not be paid from the trust proceeds.

(3) All bonuses, rental payments, royalties, and other income must be paid to the trustee until the trust is terminated and notice of its termination given to all interested parties. The trustee shall distribute all money held in the trust to the person or persons entitled to the money upon the order of the district court.

(4) A trust in favor of unlocatable owners must be kept in force until the unlocatable owners of the mineral interest in question have successfully claimed their share of the funds held in trust

and have filed the notice, as provided in 82-1-306.

(5) The trustee shall invest funds in a prudent manner, as provided in 72-34-114. Fifty percent of the interest earned on each trust must be credited to the department of revenue or, if the clerk of the court is the trustee, to the general fund of the county in which the mineral interest is located to defray the costs of administration.

(6) Funds held in the trusts are subject to the provisions governing abandoned property contained in Title 70, chapter 9.

History: En. Sec. 3, Ch. 513, L. 1979; amd. Sec. 219, Ch. 685, L. 1989; amd. Sec. 2, Ch. 126, L. 1997.

82-1-305. Trust for unlocatable mineral, leasehold, and royalty interest owners -- penalty. (1) A person may not personally hold for longer than 6 months any bonuses, rental payments, royalties, or other income for unlocatable owners or claimants of an interest in minerals underlying a tract of land. Within the 6-month period, the person shall petition the district court for creation of a trust, as provided in 82-1-302.

(2) A person failing to comply with subsection (1) is liable for all attorney fees and court costs and interest on funds subject to subsection (1) at twice the current average passbook account rate paid by financial institutions in any district in which the property or part of the property is located.

History: En. Sec. 4, Ch. 513, L. 1979; amd. Sec. 3, Ch. 126, L. 1997.

82-1-306. Filing of addresses. (1) Upon the payment of a \$5 fee, a person claiming an interest in minerals underlying a tract of land that is the subject of a trust proceeding under 82-1-302 may file with the clerk and recorder of each county in which the land is located a notice containing the person's address and a description of the person's interest in the minerals. Filing the notice creates a rebuttable presumption that the person owns the interest claimed.

(2) The clerk and recorder shall forward a copy of the notice to the trustee of the trust.

History: En. Sec. 5, Ch. 513, L. 1979; amd. Sec. 4, Ch. 126, L. 1997.

To: Jack King, Montana Board of Oil and Gas Conservation

From: N. Clyde Peterson, Agency Legal Services Bureau

Date: October 31, 2006

Re: Forced Pooling, Legal Research Update

Initial Request

The MBOGC asked me to research the forced pooling statute and the requirements for locating leaseholders by Permanent Spacing applicants who are requesting that a forced pooling order be issued by the MBOGC.

Background

After initial discussions with Jack King it became apparent that this was going to be a long-term project, with the possibility that the MBOGC would be adopting some form of guidelines for applicants. It is also possible that the MBOGC may adopt administrative rules.

Future Information Requests

After research is complete and some concrete examples of how the issue has been and is being handled here and in other states, a further information gathering tool could be used, such as sending a form letter or memorandum to various District Court Judges and attorneys active in the Oil and Gas practice to get their opinions as to specifics they have either used, recommended, or that they would prefer to see used by applicants seeking forced pooling orders.

Research Update

The following is the first report as to my research.

As of this date, my research has been confined to Internet searches on Oil and Gas Law sites, Consumer information web sites for landowners and leaseholders, legal periodicals, and, legal cases in the various states. For the sake of brevity, I will not include citations to case law or titles of articles in this report, but if requested, I can provide either copies of cases and articles, or references to them.

Initially, I began research by reference to the statute requirements in Montana, MCA section 82-11-202, and the references included in the article given to the MBOGC by Tom Richmond – REPRESENTING THE OIL PATCH WITHOUT STEPPING IN IT, A USER’S GUIDE TO MONTANA’S BOARD OF OIL AND GAS CONSERVATION, by Don Garrity and Kemp Wilson, a portion of which is quoted as follows:

...[T]he operator or agreeing owners may seek permanent spacing, and upon receiving an order for the same, seek a forced pooling order awarding costs (including the penalties) to be recovered out of the refusing owner’s share of production from the permanent spacing unit.

How is refusal to join in a project documented? A statutory presumption of refusal is created in the following manner:

An owner is presumed to have refused to pay the owner’s share of costs if prior to the spud date of the well, the owner fails to pay or agree in writing to promptly pay the share of costs after notice by the well operator either:

- (I) acknowledged in writing by the owner as received;
- (II) sent at least 30 days prior to the spud date of the well to the owner by certified mail, addressed to the owner’s address of record in the office of the clerk and recorder of the county where the well is to be drilled or the owner’s address on file with the board.

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

While there is a considerable body of law on Oil and Gas pooling issues, there appears to be surprisingly little on the issue of the amount of effort required to find the names of the “missing” owners of mineral rights. That is, how much effort to find such “missing” persons should a State or an entity such as the MBOGC require of an applicant before issuing a forced pooling order?

Again, Montana statutory law is fairly clear on this issue, but my understanding of the research assignment is to look into other state’s requirements, and into requirements beyond simply filing notice at an easily found last known address.

My research began with an examination of the law upholding “forced” or “compulsory” pooling laws. It became obvious that such laws have withstood considerable constitutional challenge all across the nation, both in State and Federal Court. I won’t go into detail here as to the specific failed challenges, as the concepts are well established.

Three points though, came to the forefront. First, generally speaking, without a specific statute, no court or administrative body can force a pooling agreement. But once enacted, the statutes, if reasonable and clear, are almost always upheld. Second, where private contractual rights [as in property rights] may be in conflict with valid administrative orders issuing compulsory or forced pooling under a statute, the latter supersedes the former. And third, when the public interest in prevention of waste of natural resources conflicts with the private interest, the public interest has to come first. Clearly, once a statutory scheme has been enacted, there is very strong law in favor of forced or compulsory pooling, and any action taken under such a statute will likely be upheld if the statute was followed by the acting agency.

The question then, in my mind, was: when the MBOGC or a similar agency is faced with a forced pooling application, does the specific statute clearly define the duties of an applicant as to how much effort must be expended to find those mineral rights holders whom the applicant states did not agree to a pooling arrangement because they could not be found?

The statute in Montana is clear as to the extent of the duty, but the question to be answered is considering the rights that are at risk, should there be more specific direction and detail?

Before getting into some case law requirements on the question at hand, I did find some anecdotal references to the pressure that is being brought to bear on landowners and mineral owners by drillers through the use [or possibly misuse] of the compulsory or forced pooling statute. I found it to be instructive as to what happens when the “letter of the law” is interpreted in a manner entirely too favorable to a party who can force an agreement on another party.

In Michigan, there were complaints by consumers that when forced pooling applicants were dealing with large amounts of land, with mineral rights owned by many people, the applicants were attempting to force nearly half of the non-agreeing or missing owners into a pool through the use of the forced pooling

statute. The applicants, who must exert “reasonable effort” to obtain a lease or find a missing person, simply found it expedient to not enter into negotiations with landowners or mineral rights owners, but just sent a proposed lease to the address of record. If no answer was obtained, the applicants apparently indicated to the state authority that “reasonable effort” was exerted to obtain a lease. As one might expect, there was general unhappiness with this approach.

In another website concerning consumer anger in Oklahoma, a mineral rights owner persisted in his attempts to negotiate the terms of a lease, and the representative of the leasing company simply told him they had gotten a couple of cheap leases in the area already, and would no longer negotiate as they could now just get a forced pooling order.

I would expect that there would be a backlash if this behavior became commonplace, and that the courts may well begin making their own rules as to what is “reasonable effort”, both as to the effort required to obtain a lease or the effort required to find any “missing” owners of mineral rights. And if the Courts are not the impetus for such in depth examination, it will most certainly fall to those statutorily created Boards who will be making the decisions.

My research into the specifics of what level of effort is required to find “missing” mineral rights owners has unearthed several cases, all quite similar. And generally, as you often find in the law, the later cases cite the same earlier cases.

I will use Oklahoma as a primary example, as there were several cases on the issue. In the earliest case, the Court set out the bedrock reason for requiring a level of effort to locate the address or name of a “missing” mineral rights owner.

A State cannot invest itself with and exercise through its courts, judicial jurisdiction over a person in a proceeding which may directly and adversely affect his legally protected interests [property and mineral rights] without employing a method of notification which is reasonably calculated to give a person knowledge at a meaningful time and in a meaningful manner of attempted exercise of jurisdiction and an opportunity to be heard. This is, simply stated, the due process that is accorded each of us as a citizen of this country.

In Oklahoma, the law was different than in Montana, in that if after making a duly diligent search the addresses could not be found, then one could do a notice by publication of the pooling application before the State Board [Board].

Nevertheless the case is instructive for its examination of how much effort is required for an address search.

As stated by the Oklahoma Court: Due process requirements contemplate that, where feasible, notice of legal proceedings be given by means reasonably calculated to inform all parties having legal rights which are to be directly and adversely affected thereby, and notice of pending proceedings by publication service alone is not sufficient where parties names and addresses are known or should be [through due diligence] easily ascertainable. Therefore, due diligence is the standard you must meet for an address search in Oklahoma.

While due diligence was not defined, the Court found it is established when facts before the Court have a legal tendency to show a diligent search and the Court is satisfied that all the primary sources such as tax rolls, deed records, judicial and other official records, as well as other secondary sources such as telephone and city directories have been exhausted in a meaningful pursuit of information. There must be a diligent search of all available sources at hand to ascertain the whereabouts or post office address of the individual in question.

Furthermore, the burden is placed on those seeking the use of publication service, rather than personal service. And finally, one cannot simply make a perfunctory sworn statement of due diligence, it must be proven. The Judge must be satisfied from the evidence at hand that a duly diligent search was made. One can assume that same duty would be imposed on the administrative Board entering a forced pooling order.

A second and later case illustrated the dangers of a lack of due diligence, and the failure of having such on the record of the administrative Board that later granted a forced pooling order based on a notice by publication rather than by personal service.

In that case, a representative of an estate sued a co-tenant of property seeking an accounting and quiet title action to an undivided mineral rights interest. The estate sought a money judgment for conversion of the proceeds from the production of minerals on the property, claiming lack of notice to the deceased.

The case illustrates what was required under a duty of due diligence [the same as above], and the dangers when a Court finds such effort was lacking. Of perhaps even more interest to the MBOGC, the Court was able to examine and re-open a

long since completed Order of forced pooling by the state Board entitled to enter such an order.

In effect, long after the time for appealing such an order had past, it was re-opened because the Court found, on examining the face of the record, that there was no examination by the Board into the “due diligence” efforts of the applicant requesting a forced pooling order.

Specifically, a District Court reviewing such an action as this one always has the authority to examine whether the Board has jurisdiction to issue a pooling order. In this case it was the personal jurisdiction of the Board over the individual that was at issue, and the Court could look into the process by which the parties were notified of the forced pooling attempt and the subsequent Board order.

The Court could examine whether the addresses of the “missing” parties were known or could have been known by the exercise of due diligence. In effect, whether the Board’s personal jurisdiction over the “missing” parties failed due to the lack of compliance with the existing mandatory law regarding notice. The Court stressed that if the addresses could be easily attained through the exercise of due diligence, and you did not do so, and then any further action would violate the due process rights of the “missing” individual, and presumably [although not in this case] such a finding may lead to a voiding of the forced pooling order

The Oklahoma Court found that the applicant’s efforts would be clearly insufficient if the name or address of the person was readily ascertainable from sources at hand; such as the local and state tax rolls, deed records, judicial and other official records, and other available secondary sources such as telephone and city directories. These must be fully exhausted before there would be a finding of due diligence.

In the end, the Court found notice by publication to be improper, because the applicant for forced pooling had not exercised, and could not prove, a duly diligent search. The order was essentially reopened and the estate was entitled to a complete accounting of payments made.

There are more cases of a similar nature, but the above are I think, illustrative of how Courts view the efforts required to locate missing persons or their addresses under a standard different than in Montana, and should provide a starting point for discussion of whether the MBOGC wishes to consider adopting some guidelines or enacting some administrative rules as to how much effort applicants in Montana

should exert in attempting to find a proper address for an individual mineral rights owner.

I will be available by phone, or email, should anyone wish to ask any further questions before the next meeting, or to further instruct me as to the directions I should take on this project.

I will also continue my research into the issue, and I plan make further reports and to draft a letter or memorandum to send to Judges and attorneys to get further information for the Board.