WEST VIRGINIA LEGISLATURE

2018 REGULAR SESSION

Introduced

House Bill 4356

BY DELEGATES CANESTRARO, STORCH, PETHTEL, BOGGS

AND FLUHARTY

[Introduced January 30, 2018; Referred

to the Committee on Energy then the Judiciary.]

A BILL to amend and reenact §22-6-8 of the Code of West Virginia, 1931, as amended, relating to requiring an oil and gas royalty be based at the point of sale between the lessor and an unaffiliated bona fide purchaser in an arms-length transaction, or, in the alternative the amount that would have been received in an arms-length transaction; requiring the sales price to be the highest value without costs; requiring the lessee to bear post-production costs incurred by the lessee; and baring the use by lessee of the netback method of calculating the amount to be paid to the owner of the working interest.

Be it enacted by the Legislature of West Virginia:

ARTICLE 6. OFFICE OF OIL AND GAS; OIL AND GAS WELLS; ADMINISTRATION; ENFORCEMENT.

§22-6-8. Permits not to be on flat well royalty leases; legislative findings and declarations; permit requirements.

(a) The Legislature hereby finds and declares:

(1) That a significant portion of the oil and gas underlying this state is subject to development pursuant to leases or other continuing contractual agreements wherein the owners of such oil and gas are paid upon a royalty or rental basis known in the industry as the annual flat well royalty basis, in which the royalty is based solely on the existence of a producing well, and thus is not inherently related to the volume of the oil and gas produced or marketed;

(2) That continued exploitation of the natural resources of this state in exchange for such wholly inadequate compensation is unfair, oppressive, works an unjust hardship on the owners of the oil and gas in place, and unreasonably deprives the economy of the State of West Virginia of the just benefit of the natural wealth of this state;

(3) That a great portion, if not all, of such leases or other continuing contracts based upon or calling for an annual flat well royalty, have been in existence for a great many years and were entered into at a time when the techniques by which oil and gas are currently extracted, produced

or marketed, were not known or contemplated by the parties, nor was it contemplated by the parties that oil and gas would be recovered or extracted or produced or marketed from the depths and horizons currently being developed by the well operators;

(4) That while being fully cognizant that the provisions of section 10, article I of the United States Constitution and of section 4, article III of the Constitution of West Virginia, proscribe the enactment of any law impairing the obligation of a contract, the Legislature further finds that it is a valid exercise of the police powers of this state and in the interest of the State of West Virginia and in furtherance of the welfare of its citizens, to discourage as far as Constitutionally possible the production and marketing of oil and gas located in this state under the type of leases or other continuing contracts described above.

(b) In the light of the foregoing findings, the Legislature hereby declares that it is the policy of this state, to the extent possible, to prevent the extraction, production or marketing of oil or gas under a lease or leases or other continuing contract or contracts providing a flat well royalty or any similar provisions for compensation to the owner of the oil and gas in place, which is not inherently related to the volume of oil or gas produced or marketed, and toward these ends, the Legislature further declares that it is the obligation of this state to prohibit the issuance of any permit required by it for the development of oil or gas where the right to develop, extract, produce or market the same is based upon such leases or other continuing contractual agreements.

(c) In addition to any requirements contained in this article with respect to the issuance of any permit required for the drilling, redrilling, deepening, fracturing, stimulating, pressuring, converting, combining or physically changing to allow the migration of fluid from one formation to another, no such permit shall be hereafter issued unless the lease or leases or other continuing contract or contracts by which the right to extract, produce or market the oil or gas is filed with the application for such permit. In lieu of filing the lease or leases or other continuing contract or contracts, the applicant for a permit described herein may file the following:

(1) A brief description of the tract of land including the district and county wherein the tract

is located;

(2) The identification of all parties to all leases or other continuing contractual agreements by which the right to extract, produce or market the oil or gas is claimed;

(3) The book and page number wherein each such lease or contract by which the right to extract, produce or market the oil or gas is recorded; and

(4) A brief description of the royalty provisions of each such lease or contract.

(d) Unless the provisions of subsection (e) <u>of this section</u> are met, no such permit shall be hereafter issued for the drilling of a new oil or gas well, or for the redrilling, deepening, fracturing, stimulating, pressuring, converting, combining or physically changing to allow the migration of fluid from one formation to another, of an existing oil or gas production well, where or if the right to extract, produce or market the oil or gas is based upon a lease or leases or other continuing contract or contracts providing for flat well royalty or any similar provision for compensation to the owner of the oil or gas in place which is not inherently related to the volume of oil and gas so extracted, produced and marketed.

(e) To avoid the permit prohibition of subsection (d) <u>of this section,</u> the applicant may file with such application an affidavit which certifies that the affiant is authorized by the owner of the working interest in the well to state that it shall tender to the owner of the oil or gas in place not less than one eighth of the total amount paid to or received by or allowed to the owner of the working interest ~~at the wellhead for the oil or gas so extracted, produced or marketed before deducting the amount to be paid to or set aside for the owner of the oil or gas in place, on all such oil or gas to be extracted, produced or marketed from the well~~ <u>at the point of sale of such oil and/or gas substances sold by the lessee in an arms-length transaction to an unaffiliated bona fide purchaser, or if the sale is to an affiliate of lessee, the price upon which royalties shall be based shall be comparable to that which could be obtained in an arms-length transaction given the quantity and quality of the oil and/or gas available for sale from the leased premises. The sales price shall equal the highest value without costs. Lessee bears all post-production costs incurred</u>

by the lessee. This section explicitly bars the use by lessee of the netback method of calculating the amount to be paid to the owner of the working interest. If such affidavit be filed with such application, then such application for permit shall be treated as if such lease or leases or other continuing contract or contracts comply with the provisions of this section.

(f) The owner of the oil or gas in place shall have a cause of action to enforce the owner's rights established by this section.

(g) The provisions of this section shall not affect or apply to any lease or leases or other continuing contract or contracts for the underground storage of gas or any well utilized in connection therewith or otherwise subject to the provisions of §22-9-1 *et seq*. of this code.

(h) The director shall enforce this requirement irrespective of when the lease or other continuing contract was executed.

(i) The provisions of this section shall not adversely affect any rights to free gas.

NOTE: The purpose of this bill is to require an oil and gas royalty be based at the point of sale between the lessor and an unaffiliated bona fide purchaser in an arms-length transaction, or, in the alternative the amount that would have been received in an arms-length transaction. The bill requires the sales price to be the highest value without costs. The bill requires the lessee to bear post-production costs incurred by the lessee. The bill bars the use by lessee of the netback method of calculating the amount to be paid to the owner of the working interest.

Strike-throughs indicate language that would be stricken from a heading or the present law and underscoring indicates new language that would be added.