Risk-Fee Business:
What You Need to Know About Recent Changes to the Louisiana Risk-Fee Statute

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Louisiana Revised Statute § 30:10, commonly referred to as the Louisiana Risk Fee Statute ("Risk Fee Statute" or "Statute") seeks to allocate, in the absence of contract, the risk of drilling certain unit wells between "drilling" owners and "non-drilling" owners.[1] Under the Risk Fee Statute, when a non-drilling owner has been sent a risk-fee notice by a drilling owner and has elected not to participate or has been deemed a non-participant in the risk and expense of drilling, the drilling owner may recoup the costs to be borne by the non-drilling owner from the non-drilling owner's share of unit production, plus a risk fee of 200% (or in some cases, 100%) of such tracts' allocated share of the cost of drilling, testing, and completing the well.

On June 6, 2012, Governor Jindal signed Act 743 amending two sections of the Louisiana Conservation Act, including the Risk Fee Statute (the "Amendment").[2] The key changes to the Statute include:

- Making alternate unit wells and cross-unit wells eligible under the Risk Fee Statute;
- Expanding the scope of the drilling owner's notice to include a detailed AFE and estimate of an owner's percentage interest in the unit;
- Requiring that the drilling owner's notice be sent before "the actual spudding" of a well;
- Expanding the permitted method of delivery of the drilling owner's notice and non-drilling owner's response to include delivery by registered mail or other form of guaranteed delivery and notification method;
- Requiring a participating party to pay for drilling costs within 60 days of spudding the well or within 60 days of receipt of detailed invoices, as applicable;
- Requiring the drilling owner to pay the non-participating party, during the recoupment period, "that portion of production" due to the non-participant's royalty owners under the terms of the agreements creating such royalties as "reflected of record at the time of the well proposal";

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[1] The Risk Fee Statute uses the term "drilling owner." For ease of discussion and because it is more commonly used, we may also refer to this party as the "operator" or "unit operator." The Risk Fee Statute also uses the term "participating owner" and "non-participating owner." For ease of discussion, you may also hear us refer to such parties as "non-operating owners" or "non-operating parties."

[2] A copy of the Amendment, as enrolled and showing red-lined changes, is attached hereto as **Exhibit A.** Act No. 743 also adds a new subsection to La. Rev. Stat. §30.5.1 authorizing the Commissioner of Conservation to create "ultra deep" units, defined as structures with a top at the depth below 22,000' TVD; this article only discusses the second part of the Act relating to the Risk Fee Statute.

- Requiring the drilling owner to pay the non-participating party, during the recoupment period, an amount equal to the non-participant's overriding royalty burdens reflected of record at the time of the well proposal, with some limitations; and

- Providing for damages and attorneys fees (after notice) against the drilling owner/operator in the event drilling owner/operator fails to pay non-participants the burdens described above.

Because the legislature did not provide a specific effective date for Act 743, by law, the default effective date was August 1, 2012. It is unclear, however, whether the changes will apply retroactively. Because the Act does not expressly provide for retroactive application and because the changes are substantive – as opposed to procedural or interpretive - and may affect vested rights, we believe that Act 743 should apply only to wells drilled after August 1, 2012.

The following is a more detailed examination of certain issues relating to the Risk Fee Statute and further discussion of the changes noted above.

WHAT AND WHO IS SUBJECT TO THE FEE RISK STATUTE?

- The Risk Fee Statute applies to commissioner formed units, designated unit wells or substitute unit wells, alternate wells and cross-unit wells.

- The Amendment expressly makes alternate wells and cross-unit wells eligible.
    - A cross-unit well is a well drilled horizontally but which is completed beneath more than one unit.

- Under the Risk Fee Statute, a drilling owner may offer other owners, broadly defined as "the person, including operators and producers acting on behalf of the person, who has or had the right to drill into and to produce from a pool and to appropriate the production either for himself or for others," the option to elect to participate in the cost, risk and expense of drilling a well.

- The Risk Fee Statute only affects third parties with whom the drilling owner has no contractual relationship or other cost-sharing agreement in place.
    - Nothing contained in it, however, can modify or change the rights and obligations under any contract between or among owners.

- The Risk Fee penalty provisions (described herein) do not apply to any mineral interests not subject to an oil, gas and mineral lease.

HOW AND WHEN MUST THE NOTICE BE SENT?

- To trigger the Risk Fee Statute, the drilling owner must send notice, by registered mail, return receipt requested, or some "other form of guaranteed delivery and notification method" to all other owners in the unit of the drilling or the intent to drill and give each owner an opportunity to elect to participate in the risk and expense of the well (the Notice").
    - Some "other form of guaranteed delivery and notification" would presumably include private carriers like FedEx or UPS.
    - The Amendment specifically excludes Notice by "electronic communication or mail".

- Under the Amendment, the Notice must be sent "prior to the actual spudding" of a well if the unit is in place on the spud date.

- If the unit is created during or after drilling, then the Notice is required to be sent within 60 days of the "date of the order" creating the unit.
    - It is unclear what is meant by "date of the order"; does this mean the date of issuance or effective date of the order?

- If the unit is revised to include an additional tract or tracts after drilling, then the Notice is required to be sent within 60 days of "date of the order" revising the unit.
    - Again, it is unclear what is meant by "date of the order"; does this mean the date of issuance or effective date of the order?

- The owners in the unit to whom the Notice may be sent, are the owners of record as of the date on which the Notice is sent.[3]

WHAT MUST A NOTICE CONTAIN?

- The Notice shall contain:
    - an AFE which shall include a detailed estimate of the cost of drilling, testing, completing, and equipping the proposed well;
        - the AFE should be dated within 120 days of the date of mailing of the Notice
    - the proposed location of the well;
    - the proposed objective depth of the well;
    - an estimate of ownership as a percentage of expected unit size or approximate percentage of well participation; and
    - if the well if being drilled or is drilled at the time of Notice, all logs, core analysis, production data, and well test data from the well which has not been made public.

[3] Note that a drilling owner must send Notice to all owners of record as of the date of Notice, meaning that the drilling owner has the obligation to perform title work before spudding the well.

HOW AND WHEN MUST AN OWNER ELECT TO PARTICIPATE?

- Any owner who elects to participate must notify the drilling owner in writing, by registered mail, return receipt requested, or some "other form of guaranteed delivery and notification method" within 30 days of its receipt of Notice.

- Failure to give timely written response shall be deemed an election not to participate.

WHEN MUST A PROPOSED WELL BE DRILLED?

- If drilling of the proposed well is not commenced within 90 days after receipt of the initial Notice, supplemental Notice is required, meaning a drilling owner must again comply with the full Notice requirements under the Statute.

WHAT ARE A PARTICIPATING OWNER'S OBLIGATIONS FOR WELL COSTS?

- An owner who chooses to participate is obligated to pay its share of drilling costs determined by the AFE within 60 days of the spudding of the well to avoid being deemed a non-participating owner subject to the risk fee.

- Likewise, any "subsequent drilling, completion and operating expenses" have to be paid within 60 days of receipt of detailed invoices, to avoid being deemed a non-participating owner subject to the risk fee.

- An owner who chooses to participate in the risk and expense of drilling a well is liable for cash payment for its proportionate share of well costs, regardless of whether there is production.[4]

WHAT IS THE RISK FEE/CHARGE FOR NON-PARTICIPATING OWNERS?

- The risk charge for a unit well, substitute unit well, or cross-unit well that will serve as **the unit well or substitute well** for the unit shall be 200% of such tract's allocated share of the cost of drilling, testing, and completing the well, *exclusive of amounts the drilling owner remits to the nonparticipating owner for the benefit of the nonparticipating owner's royalty and overriding royalty owner*.
    - Collection of this fee is in addition to the right of the drilling party to recoup 100% of drilling, testing, completing, equipping and operating costs.

- The risk charge for an alternate unit well or cross-unit well that will serve as an **alternate unit well** for the unit shall be 100% of such tract's allocated share of the cost of drilling, testing, and completing such well, *exclusive of amounts the drilling owner remits to the nonparticipating owner for the benefit of the nonparticipating owner's royalty and overriding royalty owner.*

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[4] *Shanks v. Exxon Corp.*, 07-0852 (La. App/ 1 Cir. 12/21/07), 984 So. 2d 53, 59 n. 8.

- Collection of this fee is in addition to the right of the drilling party to recoup 100% of drilling, testing, completing, equipping and operating costs.

- Example calculation for a unit well:
  - Assume (a) a drilling owner drills a *unit well* in the unit; (b) the owner of a mineral lease with 50% unit participation receives due Notice under the Statute but elects not participate; and (c) the drilling owner incurs total well costs of $525,000, broken down as follows: drilling costs = $200,000, testing costs = $50,000, completing costs = $150,000, equipping costs = $50,000, supervision charge = $50,000, and operating costs until all of such costs had been recovered out of production = $25,000.

    - In the above example, the drilling owner would be entitled to recover production allocable to the non-participating owner the sum of $662,500

      Costs to non-participating owner:

      i. Drilling costs - $200,000 x 50% = $100,000
      ii. Testing costs– $50,000 x 50% = $ 25,000
      iii. Completing costs -$150,000 x 50% = $ 75,000
      iv. Equipping costs – $50,000 x 50% = $ 25,000
      v. Supervision charge - $50,000 x 50% = $ 25,000
      vi. Operating costs - $25,000 x 50% = $ 12,500
      vii. Risk charge =$400,000
      ((total of i, ii & iii above x2) = $400,000)

      $662,500

      Note: The risk charge is 200% of the tracts allocated share of the cost of **drilling, testing and completing the well**.

WHO PAYS FOR THE NON-PARTICIPATING OWNER'S ROYALTY AND OVERRIDING ROYALTY BURDENS DURING THE RECOVERY PERIOD?

- Under the previous version of the Statute, a non-participating owner was solely responsible for its lessors' royalties and any overriding royalties carved out of its working interest during the recovery period.[5] Drilling owners previously had no responsibility for these burdens.

- The Amendment added several provisions, however, addressing the obligation of a drilling owner with respect to royalties and overriding royalties owed by non-participating owners.

[5] *See, e.g., Gulf Explorer, LLC v. Clayton Williams Energy, Inc.*, 06-1949 (La. App. 1 Cir. 6/8/07), 964 So. 2d 1042.

- Now, a drilling owner is required to provide to the non-participating owner for the benefit of the royalty holder, during the recovery period,[6] "that portion of production due to the lessor royalty owner under the terms of the contract or agreement creating the royalty between the royalty owner and the non-participating owner's reflected of record at the time of the well proposal."[7]

- Now, a drilling owner is required to provide to the non-participating owner for the benefit of the overriding royalty holder, during the recovery period, the lesser of "(i) the non-participating owner's total percentage of actual overriding royalty burdens associated with the existing lease or leases which cover each tract attributed to the non-participating owner reflected of record at the time of the well proposal" or (ii) the difference between the weighted average percentage of the total actual royalty and overriding royalty burdens of the drilling owner's leasehold interest within the unit and the non-participating owner's actual leasehold royalty burdens reflected of record at the time of the well proposal."[8]
    - Note that the latter calculation only refers to the "non-participating owner's actual leasehold royalty burdens" and not both royalty and overriding royalty burdens.
    - Note also, that if the overriding royalties attributable to a non-participant exceeds the lesser of the 2 options noted in the Statute, the non-participant is responsible for its remainder override. *See* § 30:10(b)(ii)(dd).

- The drilling owner must also provide to the non-participating owner, with the royalty and overriding royalty payment, all of the information required of under La. Rev. Stat. § 31:212.31 including:
    - Lease identification number, if any, or reference to appropriate agreement with identification of the well or unit from which production is attributed;
    - Month and year of sales or purchases included in the payment;
    - Total barrels of crude oil or MCF of gas purchased;
    - Owner's final realizable price per barrel or MCF;
    - Total amount of severance and other production taxes, with the exception of windfall profit tax;
    - Net value of total sales from the property after taxes are deducted;
    - Interest owner's interest, expressed as a decimal fraction, in production from (1) above;
    - Interest owner's share of the total value of sales prior to any tax deductions; and

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[6] The Statute now specifically defines the recovery period as the time period for "the recovery of the actual reasonable expenditures incurred in drilling, testing, completing, equipping, and operating the well, the charge for supervision and the risk charge…"

[7] Note that a drilling owner is responsible for burdens "reflected of record at the time of the well proposal" which time is not defined in the Statute. Thus, we would assume that the time of the well proposal should mean the time when Notice is sent to all owners, but this is not entirely clear from the language of the Statute. And again, it is presumably, the obligation of the drilling owner to perform leasehold title work before spudding (or proposing) a well.

[8] *See id*.

- Interest owner's share of the sales value less his share of the production and severance taxes, as applicable.

WHAT RELATIONSHIP EXISTS BETWEEN THE ROYALTY AND OVERRIDING ROYALTY OWNERS AND THE DRILLING OWNER DURING THE RECOVERY PERIOD?

- While there is no contractual privity between the drilling owner and the non-participating owner's royalty and overriding royalty holders, the Amendment specifically provides these holders (for the first time) certain rights under the Mineral Code against the drilling owner directly, including rights and remedies under La. Rev. Stat. §§ 31:133-144 relating to termination of mineral leases and remedies for violations of same and §§ 31: 212.21-212.23 relating to royalty payments to others than mineral lessor; remedies of obligee.
  - Such rights are triggered upon written notice to the non-participating owner and drilling owner as prerequisite to judicial demand for damages.
  - The drilling owner is, however, insulated from liability upon sufficient proof that royalties and overriding royalties were paid to the non-participating owner.

- A royalty or overriding royalty owner's new cause of action against a drilling owner does not limit and is additional to the rights such owners have against the non-participating owner directly.
  - Again, under the Statute, the non-participating owner remains directly responsible to its royalty and overriding royalty holders. *See* § 30:10(b)(ii)(dd).

- It is unclear as to how this new procedure will apply in practice or be interpreted by the courts.

WHAT RELATIONSHIP EXISTS BETWEEN THE NON-PARTICIPATING OWNER AND THE DRILLING OWNER DURING THE RECOVERY PERIOD?

- The Amendment adds a new provision whereby the non-participating owner has a cause of action against the drilling owner for non-payment of royalty and overriding royalty burdens under the Statute. In the event (i) the drilling owner fails to pay the burdens ***and*** (ii) the non-participating owner makes such payment ***and*** (iii) after written notice, the drilling owner either has not paid within 30 days after receipt of notice or responded with reasonable cause for nonpayment, the drilling owner will be subject to damages double the amount of royalties due, interest and reasonable attorney fees.

- More generally with respect to the relationship between drilling owners and non-participants: a non-participating owner cannot share in production until his proportionate share of the actual reasonable costs incurred in drilling, testing, completing, equipping, and operating the well, including a charge for supervision, been paid to the drilling owner ***and*** the drilling owner has recouped its risk fee charge of 200% or 100%, as applicable.

- A non-participant's liability for well expenses only accrues as there is production, and the non-participant is only liable to the extent of its proportionate share of production for the

leased tracts. Therefore, a drilling owner can only recoup a non-participating owner's proportionate share of the expenses from that lessee's proportionate share of production.[9]

- The exception to this rule is that an owner who has demanded unitization or who took the initiative in forming a unit may be liable for its entire share of costs incurred, regardless of production.[10]
    - However, an owner who merely participates in a unitization hearing, but who does not initiate or invoke such hearings, is not liable for cash reimbursement beyond its share of production. For instance, non-drilling owner who files a counter-plan seeking to modify the proposed unit is not liable to reimburse its proportionate share of expenses beyond its share of production.[11]

- To recover costs from the non-participating owner's share of production, a drilling owner must show that the expense: (1) has actually been incurred and (2) is reasonable.
    - For example:
        - Owners are not obligated to pay more than the prevailing market price for materials furnished or used in the drilling, completion, and production of any well drilled in a compulsory unit.[12]
        - Also, owners are not obligated to pay for any cost that was not related to unit operations but which was incurred out of the operator's interest.

- The Commissioner of Conservation has the authority to determine, after notice to all interested owners and a hearing, the "proper costs" in the event of a disagreement between the parties. Note, however, that the commissioner does not have the authority to apportion the costs between unit owners.

WHAT RELATIONSHIP EXISTS BETWEEN A DRILLING OWNER AND AN OWNER WHO HAS NOT BEEN RISK FEE NOTICED?

- A risk charge may not be assessed against an un-notified owner, but the drilling owner can still recover well costs from 100% of his production before having to deliver production or proceeds.

- A drilling owner cannot, however, avoid payment of an un-notified owner's royalty burdens by foregoing the risk fee charge. The Amendment requires that the "participating owner" pay the un-notified owner "the proceeds attributable to his royalty and overriding royalty burdens as described in this Section."

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9 *Davis Oil Co. v. Steamboat Petroleum Corp.*, 583 So. 2d 1139, 1143 (La. 1991).

10 *Superior Oil Co. v. Humble Oil & Refining Co.*, 165 So. 2d 905, 911 (La. App. 4 Cir. 1964).

11 *See Davis Oil Co.*, 583 So. 2d at1141, 1143-44.

12 *See* La. Rev. Stat. § 30:111.

WHAT RIGHT DOES THE DRILLING OWNER HAVE FOR RECOVERY OF WELL COSTS FROM AN UNLEASED MINERAL OWNER?

- The drilling owner has the right to withhold all proceeds of production until payout is achieved.
    - As a corollary, after payout,[13] the drilling owner is required to pay the unleased owner its pro rata share of the proceeds within 180 days of sale (since the operator is authorized to market the production and presuming the owner has made no arrangements to dispose of its share); this relationship has been described as quasi-contractual.[14]

- After payout, unleased owners, like non-participating owners, are liable for their proportionate part of the unit operating expenses.

- In response to the perceived lack of information available to unleased owners regarding payout, well and operating costs, the Louisiana legislature, in 1950, adopted La. Rev. Stat. § 30:103.1 *et seq* (the Louisiana Well Cost Reporting Statute).

WHAT IS THE UNIT OPERATOR'S DUTY TO REPORT TO UNLEASED MINERAL OWNERS?

- The Louisiana Well Cost Reporting Statute sets out two separate reporting requirements for the operator *viz a viz* unleased owners in a unit:
    - within 90 calendar days from completion of the unit well, the operator must send an initial report which must contain the costs of drilling, completing, and equipping the unit well; and
    - after establishment of production from the unit well, it must send quarterly reports containing the following:
        - The total amount of oil, gas, and other hydrocarbons produced from the lands during the previous quarter.
        - The price received from any purchaser of unit production.
        - Quarterly operating costs and expenses.
        - Any additional funds expended to enhance or restore the production of the unit well.

- These reports must be sworn, detailed, itemized and must be sent via certified mail.
    - Note that none of the delivery rules for these reports have been amended.

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[13] There is unfortunately no statutory or jurisprudential guidance regarding the definition of payout (or proper scope of deductable expenses) in this situation. One case simply stated that the unleased owner is not entitled to production until "the cost of drilling and operating the well is paid for." *Willis v. Int'l Oil & Gas Corp*., 541 So.2d 332 (La. App. 2 Cir. 1989). *See also* the Statute, which provides that a drilling owner is entitled to recover from a non-participating owner "the actual reasonable expenditures incurred in drilling, testing, completing, equipping and operating the unit well, including charge for supervision."

[14] *See Taylor v. Smith*, 619 So.2d 881, 887 (La. App. 3 Cir. 1993).

WHAT IS THE PENALTY FOR FAILURE TO REPORT TO UNLEASED MINERAL OWNERS?

- La. Rev. Stat. § 30:103.2 provides that: "Whenever the operator or producer permits 90 calendar days to elapse from completion of the well and thirty (30) additional calendar days to elapse from date of receipt of written notice by certified mail from the owner or owners of unleased oil and gas interest calling attention to failure to comply with the provisions of La. R.S. 30:103.1 such operator or producer shall forfeit its right to demand contribution from the owner or owners of the unleased oil and gas interests for the costs of the drilling operations of the well."

- The penalties imposed by La. Rev. Stat. § 30:103.2 are triggered **only** when the operator/ producer permits:
    - 90 calendar days to elapse from completion of the well;

      and

    - 30 additional calendar days to elapse from the date of receipt of written notice by certified mail from the owner or owners of unleased oil and gas interests calling attention to failure to comply with the provisions of R.S. 30.103.1, . . .

- Thus, an operator does not forfeit its right to contribution for failure to provide an initial report until 30 days have elapsed from date of receipt of letter "calling attention" to such failure.

- La. Rev. Stat. § 30:104 also provides that the operator "shall be fined not less than twenty-five dollars, nor more than one hundred dollars for each failure to report to any individual royalty or mineral owner."
    - This section is a criminal statute and does not contemplate possibility of fines being paid to a mineral interest owner; the penalty exists for purpose of inflicting punishment upon the violator and is not designed for restitution or indemnification.[16]

ENROLLED

Regular Session, 2012

ACT No. 743

HOUSE BILL NO. 504

BY REPRESENTATIVE DOVE

AN ACT

To amend and reenact R.S. 30:5.1 and 10(A)(introductory paragraph), (1), and (2), relative to pooling of oil and gas wells; to provide for authority of the commissioner of conservation to create such pools; to provide for applications, allocation of costs, and rules and regulations; to provide for the agreements for drilling units; to provide for pooling interests; to provide for the election not to participate in a unit well; to provide for payment to certain royalty owners; to provide terms and conditions; and to provide for related matters.

Be it enacted by the Legislature of Louisiana:

Section 1. R.S. 30:5.1 and 10(A)(introductory paragraph), (1), and (2) are hereby amended and reenacted to read as follows:

§5.1. Deep pool order; ultra deep structure units; application; procedure; allocation of costs; rules and regulations

A. The following shall be applicable to deep pool units:

(1) In order to prevent waste and to avoid the drilling of unnecessary wells, and to encourage the development of deep oil and gas pools in Louisiana, the commissioner of conservation is authorized, as provided in this ~~Section~~ Subsection, to establish a single unit to be served by one or more wells for a deep pool and to adopt a development plan for such deep unit.

~~B.~~ (2) Without in any way modifying the authority granted to the commissioner in R.S. 30:9(B) to establish a drilling unit or units for a pool and in addition to the authority conferred in R.S. 30:5, the commissioner upon the

application of any interested party may enter an order requiring the unit operation of any deep pool when such unit operation will promote the development of such deep pools, prevent waste, and avoid the drilling of unnecessary wells.

~~C.~~ (3) In connection with such order, the commissioner shall have the right to establish a unit for a deep pool and to unitize, force pool, and consolidate all separately owned tracts and other property ownerships within such unit. Any order creating a unit for a deep pool shall be issued only after notice and public hearing and shall be based on findings that:

~~(1)~~ (a) The order is reasonably necessary to promote the development of a deep pool and for the prevention of waste and the drilling of unnecessary wells.

~~(2)~~ (b) The proposed unit operation is economically feasible.

~~(3)~~ (c) The geologic top of the deep pool was encountered in the initial well for the pool at a depth in excess of fifteen thousand feet true vertical depth.

~~(4)~~ (d) Sufficient evidence exists to reasonably establish the limits of the deep pool.

~~(5)~~ (e) The plan of development for the unit is reasonable. The plan shall be revised only if approved by the commissioner after notice and public hearing.

~~D.~~ (4) The order shall provide for the initial allocation of unit production on a surface acreage basis to each separately owned tract within the unit.

~~E.~~ (5) No order shall be issued by the commissioner unless interested parties have been provided a reasonable opportunity to review and evaluate all data submitted by the applicant to the commissioner to establish the limits of the deep pool, including seismic data.

~~F.~~ (6) The order creating the unit shall designate a unit operator and shall also make provision for the proportionate allocation to the owners (lessees or owners of unleased interests) of the costs and expenses of the unit operation, which allocation shall be in the same proportion that the separately owned tracts share in unit production. The cost of capital investment in wells and physical

equipment and intangible drilling costs, in the absence of voluntary agreement among the owners to the contrary, shall be shared in like proportion. However, no such owner who has not consented to the unitization shall be required to contribute to the costs or expenses of the unit operation or to the cost of capital investment in wells and physical equipment and intangible drilling costs except out of the proceeds of production accruing to the interest of such owner out of production from such unit operation. In the event of a dispute relative to the calculation of unit well costs or depreciated unit well costs, the commissioner shall determine the proper costs after notice to all interested owners and public hearing thereon.

~~G.~~ (7) Upon application and after notice and public hearing and consideration of all ~~new~~ available geological and engineering evidence, the commissioner, to the extent required by such evidence, may create, revise, or dissolve any unit provided for under this ~~Section~~ Subsection or modify any provision of any order issued hereunder. Any such order shall provide for the allocation of unit production on a just and equitable basis to each separately owned tract within the unit.

~~H.~~ (8) The commissioner shall prescribe, issue, amend, and rescind such orders, rules, and regulations as he may find necessary or appropriate to carry out the provisions of this ~~Section~~ Subsection.

~~I.~~ (9) While this ~~Section~~ Subsection authorizes the initial creation of a single unit to be served by one or more wells, nothing herein shall be construed as limiting the authority of the commissioner to approve the drilling of alternate unit wells on drilling units established pursuant to R.S. 30:9(B).

B. The following shall be applicable to ultra deep structure units:

(1) In order to prevent waste and to avoid the drilling of unnecessary wells, and to encourage the development of ultra deep oil and gas structures in Louisiana, the commissioner of conservation is authorized, as provided in this Subsection, to establish a single unit to be served by one or more wells for an ultra

deep structure and to adopt a plan of development for such ultra deep structure unit. For purposes of this statute, a "structure" is defined as a unique geologic feature that potentially traps hydrocarbons in one or more pools or zones.

(2) Without in any way modifying the authority granted to the commissioner by R.S. 30:9(B) to establish a drilling unit or units for a pool and in addition to the authority conferred by R.S. 30:5 and 5.2, the commissioner, upon the application of any interested party, may enter an order requiring the unit operation of any ultra deep structure when such unit operation will promote the development of such ultra deep structure, prevent waste, and avoid the drilling of unnecessary wells.

(3) In connection with such order, the commissioner shall have the right to establish a unit no greater than nine thousand acres for an ultra deep structure and to unitize, force pool, and consolidate all separately owned tracts and other property ownerships within such unit. Any order creating a unit for an ultra deep structure shall be issued only after notice and public hearing and shall be based on findings that:

(a) The order is reasonably necessary to promote the development of an ultra deep structure and to prevent waste and the drilling of unnecessary wells.

(b) The proposed unit operation appears economically feasible.

(c) The stratigraphic top of the ultra deep structure unit is encountered or anticipated to be encountered in the initial well for the structure at a depth in excess of twenty-two thousand feet true vertical depth.

(d) Sufficient evidence exists to reasonably establish the limits of the ultra deep structure.

(e) The applicant has submitted a plan of development for the unit that is reasonable and contains the information listed under Paragraph (B)(4) of this Section. It is presumed that a reasonable plan of development will include at least one well for each three thousand acres contained in the unit.

(4) The plan of development shall include, at a minimum, the following:

(a) The applicant's estimate of the number of wells it intends to drill in the unit.

(b) The applicant's estimated time table for drilling and completing each unit well.

(c) The applicant's anticipated target depth for each such well.

(5) Upon application of any landowner or other interested party, or at the commissioner's discretion, the plan of development may be revised by the commissioner after notice and public hearing for good cause.

(6) The order creating a unit for an ultra deep structure shall provide for the initial allocation of unit production on a surface acreage basis to each separately owned tract within the unit and shall also specify the stratigraphic intervals to which the unit shall be limited.

(7) No order creating a unit for an ultra deep structure shall be issued by the commissioner unless interested parties have been provided a reasonable opportunity to review and evaluate all data, including seismic data, submitted by the applicant to the commissioner to establish the limits of the deep structure.

(8) An order creating the unit for an ultra deep structure shall designate a unit operator.

(9) The initial well and each subsequent well proposed or drilled pursuant to the plan of development shall be deemed a unit well. The provisions of R.S. 30:10(A)(2) shall be applicable to ultra deep structure units, including the applicable risk charge. In the event of a dispute relative to the calculation of unit well costs or depreciated unit well costs, the commissioner shall determine the proper costs after notice to all interested owners and public hearing thereon.

(10) Upon application by any landowner or other interested party, or at the commissioner's discretion, and after notice and public hearing and consideration of available geological, engineering, and other relevant evidence,

the commissioner, to the extent required by such evidence, may by order create, revise, confirm, or dissolve any unit provided for under this Subsection or modify any provision of any order issued hereunder. Any such order shall provide for the allocation of unit production on a just and equitable basis to each separately owned tract within the unit. The applicant shall, in all cases, have the burden of proof that the existing unit or order should be revised, confirmed, dissolved, or amended in the manner proposed in the application. If the commissioner determines that the unit operator has not substantially complied with the plan of development, the unit operator shall be required to show cause why the unit should not be reduced in size.

(11) The provisions of Subsection A of this Section shall not be applicable to any unit well drilled in a unit established pursuant to this Subsection.

(12) The commissioner shall prescribe, issue, amend, and rescind such orders, rules, and regulations as he may find necessary or appropriate to carry out the provisions of this Subsection.

(13) While the provisions of this Subsection authorize the initial creation of a single unit to be served by one or more wells, nothing herein shall be construed as limiting the authority of the commissioner to approve the drilling of alternate unit wells on drilling units established pursuant to R.S. 30:9(B).

* * *

§10. Agreements for drilling units; pooling interests; terms and conditions; expenses

A. When two or more separately owned tracts of land are embraced within a drilling unit which has been established by the commissioner as provided in R.S. 30:9(B), the owners may validly agree by separate contract to pool, drill, and produce their interests and to develop their lands as a drilling unit.

(1) Where the owners have not agreed by separate contract to pool, drill, and produce their interests, the commissioner shall require them to do so and to develop their lands as a drilling unit, if he finds it to be necessary to prevent waste or to avoid drilling unnecessary wells.

(a) All orders requiring pooling shall be made after notice and hearing. They shall be upon terms and conditions that are just and reasonable and that will afford the owner of each tract the opportunity to recover or receive his just and equitable share of the oil and gas in the pool without unnecessary expense. They shall prevent or minimize reasonable avoidable drainage from each developed tract which is not equalized by counter drainage.

(b) The portion of the production allocated to the owner of each tract included in a drilling unit formed by a pooling order shall, when produced be considered as if it had been produced from his tract by a well drilled thereon.

(2) In the event ~~pooling is required,~~ a drilling unit is formed by a pooling order by the commissioner and absent any agreement or contract between owners as provided in this Section, then the cost of development and operation of the pooled unit chargeable to the owners therein shall be determined and recovered as provided herein.

(a)(i) Any owner drilling or intending to drill a unit well, ~~including~~ a substitute unit well, an alternate unit well, or a cross-unit well on any drilling unit heretofore or hereafter created by the commissioner, may, by ~~certified~~ registered mail, return receipt requested, or other form of guaranteed delivery and notification method, not including electronic communication or mail, notify all other owners in the unit prior to the actual spudding of any such well of the drilling or the intent to drill and give each owner an opportunity to elect to participate in the risk and expense of such well. Such notice shall contain:

(aa) An authorization for expenditure form (AFE), which shall include a detailed estimate of the cost of drilling, testing, completing, and equipping ~~the unit~~ such proposed well. The AFE shall be dated within one hundred twenty days of the date of the mailing of the notice;

(bb) The proposed location of the ~~unit~~ well;

(cc) The proposed objective depth of the ~~unit~~ well; ~~and~~

(dd) An estimate of ownership as a percentage of expected unit size or approximate percentage of well participation;

(ee) In the event that the proposed well is being drilled or drilled at the time of the notice, then a copy of all available ~~All~~ logs, core analysis, production data, and well test data from the ~~unit~~ well which has not been made public.

(ii) ~~Such~~ An election to participate must be exercised by mailing written notice thereof by ~~certified~~ registered mail, return receipt requested, or other form of guaranteed delivery and notification method, not including electronic communication or mail, to the owner drilling or intending to drill the ~~unit~~ proposed well within thirty days after receipt of the initial notice. Failure to give timely written notice of the election to participate shall be deemed to be an election not to participate and the owner shall be deemed a nonparticipating owner.

(iii) ~~Another initial notice must be sent in order for the provisions of this Subsection to apply if~~ If the drilling of the proposed ~~unit~~ well is not commenced in accordance with the initial notice within ninety days after receipt of the initial notice, then the drilling owner shall send a supplemental notice in order for the provisions of this Subsection to apply.

(b)(i) Should a notified owner elect not to participate in the risk and expense of the unit well, substitute unit well, alternate unit well, or cross-unit well or should such owner elect to participate in the risk and expense of the ~~unit~~ proposed well ~~and~~ but then fail to pay his share of ~~such expenses~~ the drilling costs determined by the AFE within sixty days of the spudding of the well or fail to pay his share of subsequent drilling, completion, and operating expenses within sixty days of receipt of subsequent detailed invoices, then such owner shall be deemed a nonparticipating owner, and the drilling owner ~~drilling same~~ shall, in addition to any other available legal remedies to enforce collection of such expenses, be entitled to own and recover out of production from such ~~unit~~ well allocable to the tract ~~belonging~~ under lease to the nonparticipating owner such tract's allocated share of the actual reasonable expenditures incurred in drilling, testing, completing, equipping, and operating the ~~unit~~ well, including a charge for supervision, together with a risk charge~~, which~~. The risk charge for a unit well,

substitute unit well, or cross-unit well that will serve as the unit well or substitute well for the unit shall be two hundred percent of such tract's allocated share of the cost of drilling, testing, and completing the ~~unit~~ well, exclusive of amounts the drilling owner remits to the nonparticipating owner for the benefit of the nonparticipating owner's royalty and overriding royalty owner. The risk charge for an alternate unit well or cross-unit well that will serve as an alternate unit well for the unit shall be one hundred percent of such tract's allocated share of the cost of drilling, testing, and completing such well, exclusive of amounts the drilling owner remits to the nonparticipating owner for the benefit of the nonparticipating owner's royalty and overriding royalty owner.

(ii)(aa) During the recovery of the actual reasonable expenditures incurred in drilling, testing, completing, equipping, and operating the well, the charge for supervision, and the risk charge, the nonparticipating owner shall be entitled to receive from the drilling owner for the benefit of his lessor royalty owner that portion of production due to the lessor royalty owner under the terms of the contract or agreement creating the royalty between the royalty owner and the nonparticipating owner reflected of record at the time of the well proposal.

(bb) In addition, during the recovery set forth in Subsection (ii)(aa) of this Subparagraph, the nonparticipating owner shall receive from the drilling owner for the benefit of the overriding royalty owner the lesser of: (I) the nonparticipating owner's total percentage of actual overriding royalty burdens associated with the existing lease or leases which cover each tract attributed to the nonparticipating owner reflected of record at the time of the well proposal; or (II) the difference between the weighted average percentage of the total actual royalty and overriding royalty burdens of the drilling owner's leasehold within the unit and the nonparticipating owner's actual leasehold royalty burdens reflected of record at the time of the well proposal.

(cc) The share that is to be received by the nonparticipating owner on behalf of its lessor royalty owner and overriding royalty owner shall be reported

by the drilling owner in accordance with Part 2-B of Chapter 13 of Title 31 of the Louisiana Revised Statutes of 1950.

(dd) Nothing in this Section shall relieve any lessee of its obligations to pay, from the commencement of production, any lessor royalty and overriding royalty due under the terms of his lease, and other agreements during the recovery of actual well costs and the risk charge, or shall relieve any lessee of his obligation to pay all royalty and overriding royalty due under the terms of his lease and other agreements after the recovery of the actual well costs and the risk charge. Except as provided in this Paragraph, the drilling owner's obligation to pay the royalty and the overriding royalty to the nonparticipating owner in no way creates an obligation, duty, or relationship between the drilling owner and any person to whom the nonparticipating owner is liable to, contractually or otherwise.

(ee) In the event of nonpayment by the nonparticipating owner of the royalty and overriding royalty due, the lessor royalty owner and overriding royalty owner shall provide written notice of such failure to the nonparticipating owner and drilling owner as a prerequisite to a judicial demand for damages. The lessor royalty owner and overriding royalty owner shall follow the same procedure and have the same remedies provided in Part 6 of Chapter 7 of Title 31 of the Louisiana Revised Statutes of 1950 or Part 2-A of Chapter 13 of Title 31 of the Louisiana Revised Statutes of 1950, respectively, against the nonparticipating owner and the drilling owner. If the drilling owner provides sufficient proof of payment of the royalties to the nonparticipating owner, then the lessor royalty owner and overriding royalty owner shall have no cause of action against the drilling owner for nonpayment.

(ff) In the event of nonpayment by the drilling owner of the royalty and overriding royalty due to the nonparticipating owner for the benefit of the lessor royalty owner and overriding royalty owner, and payment by the nonparticipating owner of the royalty and overriding royalty due, the nonparticipating owner shall provide written notice of such failure to pay to the drilling owner as a prerequisite

to a judicial demand for damages. The drilling owner shall have thirty days after receipt of the required notice within which to pay the royalties due or to respond in writing by stating a reasonable cause for nonpayment. If the drilling owner fails to make payment of the royalties or fails to state a reasonable cause for nonpayment within this period, the court may award to the nonparticipating owner as damages double the amount of royalties due, interest on that sum from the date due, and a reasonable attorney fee regardless of the cause for the original failure to pay royalties. If the drilling owner provides sufficient proof of payment of the royalties to the nonparticipating owner, then the nonparticipating owner shall have no cause of action against the drilling owner for nonpayment.

(iii) Any owner not notified shall bear only his tract's allocated share of the actual reasonable expenditures incurred in drilling, testing, completing, equipping, and operating the unit well, including a charge for supervision, which share shall be subject to the same obligation and remedies and rights to own and recover out of production in favor of the drilling party or parties as ~~hereinabove~~ provided in this Subsection. A participating owner shall deliver to the owner whom has not been notified the proceeds attributable to his royalty and overriding royalty burdens as described in this Section.

(c) Should a drilling unit be created by order of the commissioner around a well already drilled or drilling and including one or more tracts as to which the owner or owners thereof had not participated in the risk and expense of drilling such well, then within sixty days of the date of the order creating such unit the provisions ~~hereinabove~~ of this Subsection for notice, election, and participation shall be applicable as if a ~~unit~~ well were being proposed by the owner who drilled or was drilling such well; however, the cost of drilling, testing, completing, equipping, and operating the well allocable to each tract included in the unit shall be reduced in the same proportion as the recoverable reserves in the unitized pool have been recovered by prior production, if any, in which said tract or tracts did not participate prior to determining the share of cost allocable to such tract or tracts.

(d)(i) Should a drilling unit be revised by order of the commissioner so as to include an additional tract or tracts, then within sixty days of the date of the order revising such unit the provisions ~~hereinabove~~ of this Subsection for notice, election, and participation shall be applicable to such added tract or tracts and the owner thereof as if a ~~unit~~ well were being proposed by the owner who had drilled the ~~unit~~ well; however, the cost of drilling, testing, completing, equipping, and operating the unit well shall be reduced in the same proportion as the recoverable reserves in the unitized pool have been recovered by prior production, if any, in which said tract or tracts did not participate prior to determining the share of cost allocable to the subsequently included tract or tracts.

(ii) Should a drilling unit be revised by order of the commissioner as to exclude a tract or tracts, the cost of drilling, testing, completing, equipping, and operating the unit well shall be reduced in the same proportion as the recoverable reserves in the unitized pool have been recovered by prior production to determine the share of cost allocable to the subsequently excluded tract or tracts.

(e)(i) The provisions of ~~Paragraph 2(b) above~~ Subparagraph (b) of this Paragraph with respect to the risk charge shall not apply to any unleased interest not subject to an oil, gas, and mineral lease.

(ii) Notwithstanding the provisions of ~~Paragraph 2(b) above~~ Subparagraph (b) of this Paragraph, the royalty owner and overriding royalty owner shall receive that portion of production due to them under the terms of the contract creating the royalty.

(f) In the event of a dispute relative to the calculation of unit well costs or depreciated unit well costs, the commissioner shall determine the proper costs after notice to all interested owners and a public hearing thereon.

(g) Nothing contained herein shall have the effect of enlarging, displacing, varying, altering, or in any way whatsoever modifying or changing the rights and obligations of the parties thereto under any contract between or among owners having a tract or tracts in the unit.

(h) The owners in the unit to whom the notice provided for hereinabove may be sent, are the owners of record as of the date on which the notice is sent.

* * *

SPEAKER OF THE HOUSE OF REPRESENTATIVES

PRESIDENT OF THE SENATE

GOVERNOR OF THE STATE OF LOUISIANA

APPROVED: _____