

RAFI-USA

Rural Advancement Foundation International-USA

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May 16th, 2012

Lynne Weaver
Assistant Attorney General
Consumer Protection Division
North Carolina Department of Justice

Re: Session Law 2011-276 Consumer Protection Report Comments

Dear Ms. Weaver:

The Rural Advancement Foundation International-USA thanks the Consumer Protection Division of the Attorney General's office for their extensive research on landowner impacts and consumer protection issues related to natural gas drilling. As a consultant for the Division on this report, RAFI-USA believes the Division gave fair consideration to all of our submitted content and recommendations for the report. Given the limited resources and time available for this research, the report successfully describes the state of oil and gas rights leasing for landowners and many of the "long-lasting and profound impacts on landowners."¹ This analysis provides an important starting point for discussing landowner protections in gas rights leasing in North Carolina.

In submitting comments on the Report's recommendations, we support the Report's statement that "serious risks extend not only to the landowners who lease their land for fracking-related development, but to neighbors, communities, and the State." As highlighted in several sections of the Report, many issues will require further detailed study, and "additional legal protections put in place to protect landowners and homebuyers."² We believe further study of these issues is necessary before North Carolina moves forward on deciding the appropriate action regarding shale gas development.

Many of the recommendations in the Report reference legal precedent and common industry practices in other states and do not go far enough to protect landowners and the public from the impacts of shale gas development. In consulting with the Division for this report, we found that every state approaches shale gas impacts and property rights issues differently, but no state adequately or effectively addresses all of the potential landowner impacts. This finding is supported by the Report, which in no part contains Division comments indicating that any state is currently regulating shale gas development adequately or effectively protecting landowners. We believe it is critical to recognize that in no part of the Report does the Division state that its recommendations will lead to model landowner protections.

Below we have included RAFI-USA's comments on the recommendations of the report. Again we thank the Division for their time and efforts in conducting important analysis of landowner impacts and consumer protection issues.

Sincerely,

Jordan Treakle
Mineral Rights Project Coordinator, RAFI-USA

¹ North Carolina Department of Justice Consumer Protection Division "Impacts on Landowners and Consumer Protection Issues" Report, 37

² North Carolina Department of Justice Consumer Protection Division "Impacts on Landowners and Consumer Protection Issues" Report, 1.

RAFI-USA recommends modification to the following Division recommendations:

- **Forced Pooling**

Issue Summary

Forced Pooling allows gas operators to extract gas from an entire drilling unit (the area of planned gas extraction) even if not all of the landowners have agreed to lease the rights to their land. Forced pooling is a form of eminent domain that allows the gas company to force landowners who have chosen not to lease their property into a lease agreement and extract gas from their property against their will.

Report Summary

In Sections 5B, 5C, and 5D, the Division provides an analysis of NC's limited and outdated pooling law and forced pooling laws in other states, but the Division does not make a definitive recommendation on this issue. The Division recommends further study, input from DENR, and several important considerations if forced pooling laws were to be passed in North Carolina.

RAFI-USA's recommendations

RAFI-USA urges the Division to revise this recommendation to allow voluntary landowner pooling of gas resources but prohibit forced pooling in North Carolina. Forced pooling violates landowners' property rights and can act as an unwanted taking of landowner assets. It limits landowners' ability to manage their gas resources in a manner that maximizes their financial benefits. Additionally, forced pooling laws can contribute to pressure sales and unfavorable lease terms for landowners. If forced pooling does take place in North Carolina it must be closely regulated so that it is used sparingly, occurs only when more than a super-majority of landowners support pooling, and very strong protections and significant compensation are afforded to landowners who are unwillingly forced into a contract.

- **Assignment**

Issue Summary

Assignment of a lease involves a gas operator or "landman" negotiating a lease with a landowner and then selling (also known as "flipping") the lease to a different gas operator. A lease may change hands many times before the lease is enforced. In North Carolina, landowners cannot object to this lease sale from one company to another and there is no requirement that the landowner must be notified that the assignment occurred.

Report Summary

In Section 4G, the Division offers only a limited analysis of how assignment impacts landowners and dedicates the majority of the section to discussing assignment from the perspective of the gas operator. The Division recommends providing landowners with notification of an assignment but does not recommend that landowners have the ability to object to a sale.

RAFI-USA's recommendations

RAFI-USA believes both mineral and surface owners (if they are different parties) should be notified of assignments. Furthermore, RAFI-USA strongly urges the Division to revise their recommendation to allow landowners to object to a lease sale if they feel it is not in their interest for a different gas operator to lease their gas rights.

Assignment without landowner notification and approval prevents the landowner from benefiting from negotiating contracts with specific gas operators based on their good safety and environmental compliance records and reduces the incentive for companies to treat landowners well as an advantage in attracting business. Assignment can also lead to significant problems

when the landowner does not know who is drilling on their property. Although assignment notification is an important and basic landowner rights provision, is not a strong protection.

- **Notification**

Issue Summary

Landowner notification is the period of time prior to beginning drilling activities that a gas operator must tell the landowner that they intend to enter their property. This notification may come years after the lease was signed and therefore is a critical window of opportunity for landowners to secure any assets on their property that could be impacted by drilling activities. NC Session Law 2011-276 took an important step in requiring minimum notification periods, but these notification periods are inadequate (7-14 days notification depending on the drilling activity).

Report Summary

In Section 3B of the Report, the Division notes that North Carolina notification periods are “relatively short” and offers a limited discussion of the importance of these notification periods, especially for surface owners who do not own their mineral rights. The Division recommends a limited notification requirement increase to 30 days for activities that disturb the surface. The Report offers no recommendation for extension of notification requirements for gas operator activities that do not disturb the surface.

RAFI-USA’s recommendations

RAFI-USA strongly urges the Division to revise this recommendation and offer landowners more protection. Surface-owners and surface-lessees should be given at least 30 days notification prior to any kind of drilling activity that will not disturb the surface of the property. For activities that do cause surface disturbance, surface-owners and surface-lessees should receive notification 90-180 days prior to the gas operator entering the property. If, for valid reason, the surface-owner or surface-lessee cannot secure his/her property within these allotted amounts of time, the surface-owner or surface-lessee and gas operator should negotiate in writing a reasonable timeframe that is acceptable to both surface-owner or surface-lessee and gas operator. Additional notification time should be afforded to surface-owners or surface-lessees with farmland or forestry resources in order for crops to be harvested within one season

- **Setbacks**

Issue Summary

Natural gas drilling is an industrial activity involving noise and light pollution as well as heightened risks for industrial-scale accidents such as well blow outs and chemical fires. Establishment of minimal distances for setbacks or buffer zones for drilling activities from infrastructure, residences, property lines, and community spaces is critical in protecting landowner property rights and community assets.

Report Summary

In Section 7 of the Report, the Division states that “substantial” setback requirements should be established to protect landowners, but does not specify this distance.

RAFI-USA’s recommendations

RAFI-USA believes the Division should offer a detailed discussion on the importance of setbacks from a consumer protection perspective and offer its own recommendation on substantial setback distances of at least 1000 ft in order to protect landowner rights, assets, health, and quality of life.

- **Minimum Landowner Payment**

Issue Summary

Financial interest is the main reason most landowners choose to lease their gas rights, so it is critical that landowners receive fair compensation for leasing their property. Landowner compensation typically comes in two forms: one-time bonus payments that are determined by the number of acres of gas rights leased; and royalty payments that are determined on the amount and market price of the gas extracted from the landowner's property (the minimum rate in many states is 12.5% but this is often negotiated upward of 20%). Bonus payments in other parts of the country can vary widely, but it is not uncommon for landowners to receive thousands of dollars per acre. North Carolina landowners are not receiving the compensation they deserve and being told by gas operators and "landmen" that they cannot negotiate a better price for their resources. Most North Carolina landowners are receiving \$1-\$10 per acre. Royalty payments in North Carolina appear to generally be 12.5% (but North Carolina does not have a mandatory minimum royalty rate like other states).

Report Summary

In Section 6 of the Report, the Division offers a lengthy discussion of royalty payments. The Division acknowledges that several other states have adopted minimal royalty rates, as well as protections to limit gas operators from deducting development costs from landowner payments and flaring gas without landowner compensation. The Division does not make any strong landowner protection recommendation on these issues but rather suggests further study.

RAFI-USA's recommendations

North Carolina needs to adopt minimum landowner payment requirements to ensure fair compensation for landowners. These rates should be based on bonus payment and royalty rates in other states and should be allowed to be negotiated higher by landowners. Furthermore, gas operators should be prohibited from deducting development costs, flaring gas, or conducting any other activity that unfairly reduces landowner compensation.

- **Landowner Education**

Issue Summary

Landowner education of the financial risks and legal liabilities of gas rights leasing is critical to protecting landowners and community assets from the impacts of shale gas drilling

Report Summary

In Section 4B the Division highlights the lack of landowner knowledge of gas leases and this can lead to pressure sales and unfair leases devoid of important protections for landowners. The Division recommends that landowners be required to receive educational materials, prepared by government agencies and NC Cooperative Extension, when offered a gas lease contract.

RAFI-USA's recommendations

RAFI-USA supports this recommendation as an important first step in preventing predatory leasing practices. But we feel that in addition to information sheets, a government funded and operated Landowner Gas Rights Education Center should be established to provide up-to-date consumer protection resources related to gas leasing available to the public and support landowners throughout the leasing and drilling process.

- **Pugh Clause**

Issue Summary

A Pugh Clause is an important landowner protection that allows landowners to control leased property that is not being used by gas operators for gas extraction.

Report Summary

In Section 5D of the Report, the Division highlights the importance of Pugh clauses to prevent parts of a landowner's property being tied up in lease contracts without gas resources (and as a consequence, royalty payments) being extracted. The Division recommends a statutory Pugh clause, but only in the context of forced pooling.

RAFI-USA's recommendations

RAFI-USA strongly urges the Division to revise this recommendation and protect all landowner engaged in gas rights leasing. This important protection should be extended to all landowners, regardless of pooling laws.

RAFI –USA supports the following Division recommendations, but recommends modifications:

- **Landowner Input on Infrastructure Placement**

Issue Summary

Drilling operations and gas infrastructure development have a range of direct land impacts. Land needed for well pads, access roads, gathering lines, compressor stations etc. cannot be used by the surface owner for other purposes. In cases of split estates, surface owners living above leased mineral estates may be impacted by surface drilling activities but not benefiting financially from gas extraction. To protect surface-estate owners and their assets, surface owners must be able to influence where drilling infrastructure is placed on their property. Without this protection drilling infrastructure can interfere with other uses of the surface owner's property, such as agriculture or forestry, and degrade their quality of life without compensation or recourse. Surface owners additionally must be adequately compensated for surface impacts.

Report Summary

In Section 3C and 2B of the Report, the Division acknowledges the importance of safeguards for protecting surface owners from surface damages associated with drilling activities, especially when these surface owners are not involved in the mineral leasing process. In these two sections the Division recommends North Carolina adopt a "reasonable accommodation doctrine," require gas operators to negotiate surface-use agreements with landowners (including fair compensation for use of the surface), and expand gas operator requirements to compensate surface owners for damages.

RAFI-USA's recommendations

RAFI-USA supports these recommendations with the following additional provisions:

- Surface-use negotiations occur before a gas operator receives a drilling permit.
- An appropriate state government agency provides landowners with adequate information on property rights and protections and the "reasonable accommodation doctrine" in order to negotiate a fair surface-use agreement
- Gas operators are required to disclose a comprehensive list of risks and possible damages that could occur due to drilling activities during surface-use agreement negotiations
- A fair state-sponsored mediation program is established for cost effective dispute resolution without binding arbitration.

- **Expansion of Damage Compensation**

In Section 3D the Division provides an analysis of possible damage costs, tax liabilities, and decrease in land value due to drilling activities. The Division recommends expanding damage and expense compensation for surface owners.

RAFI-USA supports this recommendation and urges the Division to extend these important protections to mineral-estate owners as well as surface owners.

- **Expansion of Landowner Protections for Water Supply Damages**

In Section 3E the Division offers an important analysis of water supply risks due to drilling operations and the lack of protection afforded by current North Carolina law. The Division makes important recommendations on the need for expanded protections including presumption of causation, requirements for gas operators to conduct water testing prior to drilling, and requirements for gas operators to restore or replace damaged water resources at no cost to the landowner.

RAFI-USA supports these recommendations with the following additional provisions:

- Baseline testing should not be limited to water but should include soil and air quality
- Specific and strict timelines for when water and soil resources must be replaced by gas operators must be established
- Water, soil, and air quality testing should be paid by the gas operator but conducted by an independent third-party
- All water, soil, and air testing results and documentation of damages must be public information made available to landowners on neighboring properties.

- **Reclamation**

Reclamation is the process of removing drilling equipment from the landowner property, restoring the property so that it can be used for other activities, and safely closing the well after gas drilling has finished. Without substantial bonding and strict reclamation requirements, landowners can be left with the significant cost and unfair financial burden of restoring their property.

In Section 3F the Division offers a limited discussion of reclamation and bonding and provides an important recommendation on requiring gas operators to pay for reclamation of the property. In Section 3G the Division recommends that “bond amounts for operators be increased substantially” to cover this cost of reclamation and damage compensation.³

RAFI-USA supports these recommendations, and we urge the Division to provide greater detail on adequate bond amounts for reclamation and the responsibilities of gas operators for restoring a property and penalties when this responsibility is not fulfilled.

- **Full Chemical Disclosure and Violations**

In Section 7 the Division recommends full disclosure of hydraulic fracturing chemicals to DENR and local government. But this recommendation does not require disclosure to the public and does not include disclosure of trade secrets which can include chemical composition of drilling fluids. RAFI-USA supports the Division’s recommendation of full disclosure of hydraulic fracturing chemicals and strongly supports extending this requirement to include trade secrets and disclosure to the public.

³ North Carolina Department of Justice Consumer Protection Division “Impacts on Landowners and Consumer Protection Issues” Report, 34

RAFI-USA supports the following Division recommendations:

- **“Cooling off” periods**

A “cooling off” period is the amount of time after signing a contract that a landowner can consider their decision and choose to cancel the contract without penalty. For door-to-door sales, consumers have three days to review their decision, but there is no “cooling off” period for gas right leases. Gas rights leases are very complicated legal contracts that can have significant long-term legal and financial ramifications for landowners as well as direct land impacts. Most North Carolina landowners have never seen a gas rights lease before and there are few legal and risk management resources available in this state for landowners at this time. This puts landowners in a compromised position for negotiate a fair lease that protects their interests. Given the nature of these contracts, a lengthy “cooling off” period is a critical landowner protection. RAFI-USA commends and supports the Division for their strong recommendation of a 30 day cooling off period.

- **Maximum Contract Lengths**

Gas operators that enter into oil and gas rights contracts with landowners are given specified periods of time to build drilling infrastructure and begin gas extraction on a landowner’s property. Generally if the operator does not begin to conduct a designated gas development or extraction activity within the specified periods of time, typically the lease will end and the landowner will regain control of the gas rights.

According to Section 3D of the Division’s Report “the goal of landowners who lease their oil and gas rights is to obtain development of their property as soon as possible.”⁴ Thus it is in the interest of the landowner for the primary and secondary drilling phases to be as short as possible. The typical primary phase length is 1-5 years in contracts found in other gas producing states. But in North Carolina, contracts offer excessively long primary and secondary drilling term lengths of 15 and 20 years, which the Report states is an “extremely long term.”⁵

Excessively long contract lengths put unnecessary liability on landowners because they do not know when drilling will occur and impact the surface of their property. RAFI supports the Division’s recommendation of narrowly defining gas “production” activities terms in order to limit predatory extensions of leases beyond 10 years without fair landowner compensation.

- **Indemnification**

In Section 3G of the Report, the Division provides a detailed analysis of landowner indemnification protections under current North Carolina law. RAFI-USA supports the Division’s critical recommendation that indemnification protections be expanded to provide the “broadest” protection for landowners.

- **Financial Impacts**

In Section 1B the Division offers a detailed analysis of the potential financial impacts of gas leasing to landowners’ financial security. In particular, the Report examines the possibility of gas leasing violating the terms of a landowner’s mortgage loan. RAFI-USA strongly supports the Division’s recommendation regarding landowner notification of this financial liability.

⁴ North Carolina Department of Justice Consumer Protection Division “Impacts on Landowners and Consumer Protection Issues” Report, 44

⁵ North Carolina Department of Justice Consumer Protection Division “Impacts on Landowners and Consumer Protection Issues” Report, 43

- **Ownership of Oil and Gas Rights**

In Section 2A the Division offers a detailed analysis of split estates and the potential problems that face surface owners who do not own their mineral rights. RAFI-USA supports the Division's recommendations that property sellers who reserve the mineral estate must provide a prominent notification of reservation at the time the buyer makes an offer to purchase the property.

- **Posting of Full Lease**

In Section 4E the Division recommends that full gas leases be recorded at County Register of Deeds offices by gas operators within 30 days of signing. RAFI-USA supports this recommendation.