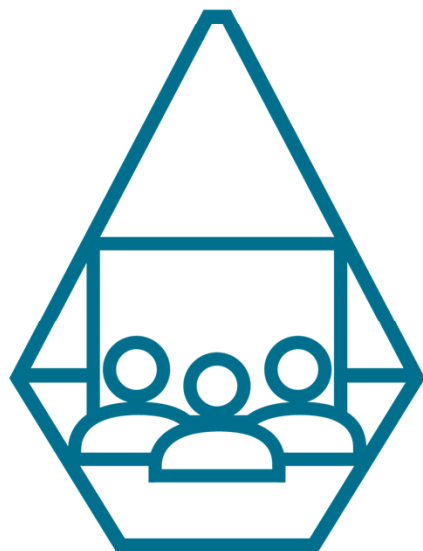


RISK FEE UPDATE

Scott Patton





AAPL ENERGY INSTITUTES

RISK FEE UPDATE

Rights and Obligations Between Drilling Owners and Nonparticipating Owners Under Louisiana's Risk Fee Statute (30:10)

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AN UPDATE TO:

LOUISIANA'S RISK FEE STATUTE WHERE ARE WE? WHERE ARE WE GOING?

**PRESENTED TO THE
AAPL GULF COAST LAND INSTITUTE
OCTOBER 17, 2019**

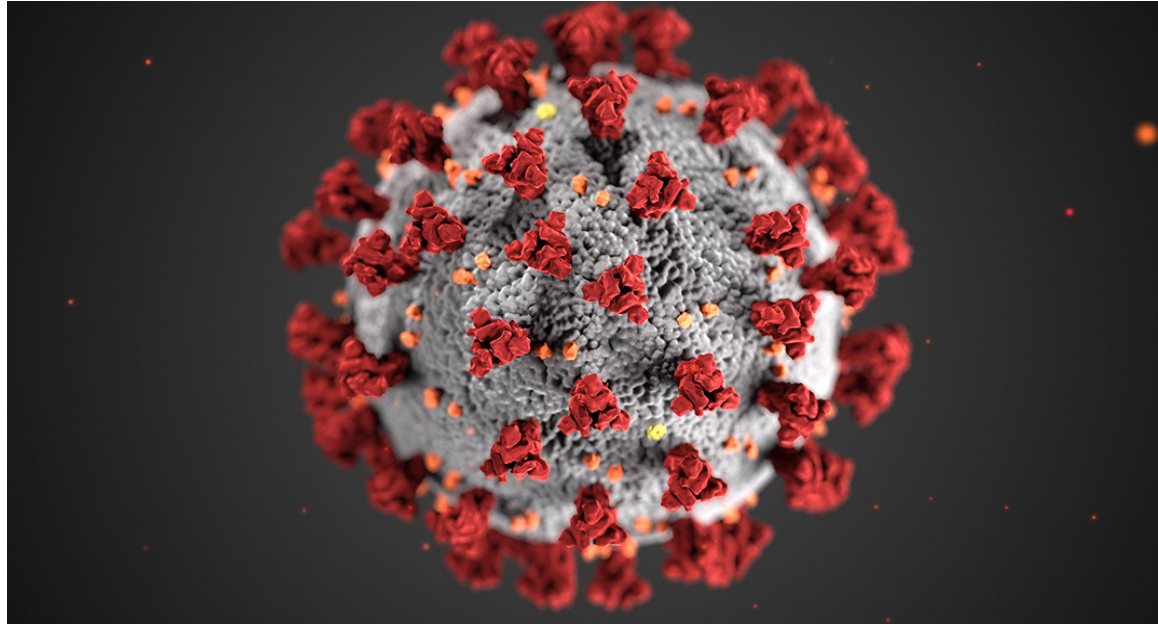


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FLASHBACK: 2019

What was going on?

- NORTH KOREAN MISSILE TESTS
- HONG KONG PROTESTS
- MASS SHOOTINGS
- DONALD TRUMP BEGINNING REELECTION CAMPAIGN AMIDST CONTROVERSY



Late October 2019

A cluster of patients in China's Hubei Province, in the city of Wuhan, begin to experience the symptoms of an atypical pneumonia-like illness that does not respond well to standard treatments.

AUNT BECKY ARRESTED!!!



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But it was not all bad!!!



J-LO AND A-ROD ENGAGED!!!



HARRY AND MEGHAN
WELCOME BABY
ARCHIE!!!



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TAYLOR SWIFT AND KATY PERRY SETTLE THEIR FEUD!!!



BUT SERIOUSLY...

Let's talk about risk, and its
associated charge.



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Brief Overview

Louisiana's "Risk Fee Statute" (La. R.S. 30:10) governs the rights and obligations between the operator and all other owners (working interest owners, unleased mineral owners, royalty owners, and overriding royalty interest owners) in a drilling and production unit created by the Commissioner of Conservation.

Brief Overview

“In the event 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.”

La. Rev. Stat. Ann. § 30:10



Statutory History

- Conservation Act of 1940 (Act No. 157, 1940 La. Acts 610) did not provide a method for an operator to be compensated for risk, but did provide framework for the later adoption of the Risk Fee Statute.
- **HUMBLE START TO THE STATUTE WHICH HAS GOTTEN MORE COMPLICATED OVER TIME**

Statutory History

- **1984 Amendment (Act No. 345, 1984 La. Acts 929)**
 - Permits (but does not obligate) an operator to afford a third-party owner of a mineral lease “an opportunity to elect to participate in the risk and expense” of the unit well
 - Procedures for notice
 - Deadlines for election and payment
 - For non-participants or for those who fail to pay, recoupment and penalty provisions
 - What costs can be recouped

Statutory History

- **1991 Amendment (Acts No. 595, 1991 La. Acts 1913)**
 - Addressed problem areas that arose in court decisions
 - Well cost adjustments
 - Unit revisions
 - Units created around wells already drilling

Statutory History

- **2008 Amendment (Acts No. 155, 2008 La. Acts 1248)**
 - Amended to increase the Risk Charge from 100% to 200%
 - No other changes made

Statutory History

- **2012 Amendment (Act No. 743, 2012 La. Acts 3030)**
 - Among other things, the 2012 amendment added several provisions addressing the obligation of a drilling owner to pay royalties (and overriding royalties) owed by non-participating interest owners to others.
 - The 2012 Amendment required Risk Fee Notices to be sent before the spudding of a well.
 - The pre-2012 version of the statute required a drilling owner to send the Risk Fee notices to non-drilling owner lessees before the completion of the well.

2016 Revision to the Risk Fee Statute

- **2016 Amendment Act No. 524, effective June 13, 2016**
- Allows the drilling owner to send the Risk Fee Notices after a well was spud or even completed.
 - By allowing for the notice to be sent after a well has been completed.
 - Clarified that the operator's failure to provide a Risk Fee notice to one non-operator lessee would not affect the validity of a Risk Fee notice being properly provided to any other non-operator lessee.
 - A third-party lessee who receives a Risk Fee Notice cannot attack the validity of that notice by arguing that someone did not timely receive a proper notice.
 - The prior version of the Risk Fee Statute did not directly address this issue.



EXISTING PROBLEM AREAS - 2019

- Problem areas and unanswered questions presented in the wake of the 2012 and 2016 revisions to the Statute
- Frequent disagreement among operators as to interpretation and application of various provisions of the statute
- Notice and penalty provisions in regards to subsequent operations
- Payments to third party lessor royalty owners in different temporal scenarios
- Inability of the Risk Fee Statute to keep up with advances in horizontal drilling technology and business practices

LOUISIANA STATE LAW INSTITUTE

Risk Fee Act Committee

- Senate Resolution No. 31 (“SR31”) of the 2016 Second Extraordinary Session of the Louisiana Legislature
 - Tasked the Louisiana State Law Institute to study the implications of Act 743 of the 2012 Regular Session on the Risk Fee Statute



LOUISIANA STATE LAW INSTITUTE

Risk Fee Act Committee

- SR31 - Stated that the purpose of the “Risk Fee Act” was to:
 - (1) Incentivize a party to share in the cost, risk, and expense of drilling a well in a compulsory unit
 - (2) Compensate a party for the risk that it assumes in drilling a well

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Risk Fee Act Committee

- SR31 - Stated that the certain provisions of Act 743 of 2012:
 - (1) May frustrate the original policy and purpose of the 1984 legislation
 - (2) May serve as a disincentive to a party who does not share in the risk associated with the drilling of a well
 - (3) Reward such nonparticipating party for its failure to share in the risk of drilling a well

LOUISIANA STATE LAW INSTITUTE

Risk Fee Act Committee

- Issued its Interim Report on January 31, 2017
- Committee identified certain areas in need of consideration
- Also requested feedback and comments from industry participants

LOUISIANA STATE LAW INSTITUTE

Risk Fee Act Committee

- Issued a report to the Law Institute Council on December 18, 2020
- Served as the basis for Senate Bill No. 59. of 2021 Regular Session
- However, Senate Bill No. 59 hit resistance in committee and was withdrawn for “further study”

LOUISIANA STATE LAW INSTITUTE

Risk Fee Act Committee

- Senate Concurrent Resolution No. 44 of the 2021 Regular Session, Concurrent Resolution created the “Risk Charge Commission”
- New Commission had a deadline of February 4, 2022 to report back to legislature
- Among other things, intended to incorporate more diverse points of view – royalty owners, DNR, etc.

Risk Fee Commission

- Resulted in Senate Bill 38, which became Act No. 5 of the 2022 Legislative Session
- Senate Bill 38 largely resembled Senate Bill 59 of 2021, with some revisions and supplemental language intended to clarify the revisions

2022 Revisions

The 2022 revisions were enacted by Act 5 of the 2022 Regular Session of the Louisiana Legislature and are effective as of August 1, 2022.



HOW THE STATUTE WORKS

Procedure with 2022 revisions highlighted

RISK CHARGE NOTICE

“In the event 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.”

La. Stat. Ann. § 30:10

1. COMMISSIONER’S UNIT

2. NO AGREEMENT BETWEEN THE OWNERS



Who is an OWNER?

- “**Owner**” means 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.

La. Stat. Ann. § 30:3

2022 REVISION

Cleaned up some inconsistent references to the parties in the statute

DRILLING OWNER

AKA The Operator

Owner “drilling, intending to drill, or who has drilled a unit well”
(also, substitute, alternate or cross-unit wells)

NONPARTICIPATING OWNER

Typically a third-party lessee owning a lease within a unit,
who either elects not to participate or elects to participate and
fails to pay costs under the statute



RISK CHARGE NOTICE

- To trigger the non-consent penalty under the Risk Fee Statute, the Drilling Owner may send notice to “all other owners in the unit of the drilling or the intent to drill and give each an opportunity to elect to participate in the risk and expense of the well.”

RISK CHARGE NOTICE

- “RISK CHARGE NOTICE” – now a defined term in the statute
- Method of delivery: registered mail, return receipt requested, or other form of guaranteed delivery and notification method, not including electronic communication or mail.

RISK CHARGE NOTICE

CONTENTS

- (aa) An authorization for expenditure form (**AFE**), which shall include a detailed estimate or the actual amount of the cost of drilling, testing, completing, and equipping such well...
- (bb) The proposed or actual **location of the well**.
- (cc) The proposed or actual objective **depth of the well**.
- (dd) An **estimate of ownership** as a percentage of expected unit size or approximate percentage of well participation.
- (ee) In the event that the well is being drilled or has been drilled at the time of mailing the risk charge notice, then a copy of **all available logs, core analysis, production data, and well test data** from the well which has not been made public.



RISK CHARGE NOTICE

CONTENTS

- (ff) At the option of the drilling owner, a statement that payment in full of the notified owner's share of costs as set forth in the AFE is required to be included with any election to participate.

NEW PROVISION 2022

Drilling Owner can demand up-front payment of costs
CASH CALL OPTION



Electing to Participate

- The operator now has the option to require that any owner electing to participate in a proposed operation pay its share of the estimated costs at the time the owner submits its election to participate.

Electing to Participate

- An owner may elect to participate in the risk and expense of the proposed well by mailing written notice by registered mail, return receipt requested, or other form of guaranteed delivery and notification method, not including electronic communication or mail, of such election to the operator within thirty days of receipt of the Risk Charge Notice.
- If the drilling owner has demanded up-front payment of costs, then the election to participate must include payment of costs as set forth in the AFE.

FINANCIAL ADJUSTMENTS

2022 revision allows for adjustments between estimated and actual costs:

“In cases where some or all of the AFE, costs are estimated, financial adjustments shall be made between the **drilling owner** and the **participating owners** within sixty days of receipt of detailed invoices in order to account for the difference between any cost estimates and actual costs.”

HOW TO BECOME A NONPARTICIPATING OWNER

1. Failure to give timely written notice of the election to participate shall constitute an election not to participate in the risk and cost of the well and the owner shall be deemed a “nonparticipating owner.”
2. Failure to pay up-front costs, if required by drilling owner.
3. Elect not to participate.
4. Elect to participate, but then fail to pay your costs (if not required up front).

CONSEQUENCES OF BEING A NONPARTICIPATING OWNER

The drilling owner shall:

1. in addition to any other available legal remedies to enforce collection of such expenses,
2. be entitled to own and recover out of production from such well allocable to the tract 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 well, including a charge for supervision,
3. together with a risk charge.

RISK CHARGE

1. **UNIT WELL, SUBSTITUTE UNIT WELL, OR CROSS-UNIT WELL SERVING AS THE UNIT WELL:** Two hundred percent (200%) of such tract's allocated share of the cost of drilling, testing, and completing the well.
2. **ALTERNATE UNIT WELL:** One hundred percent (100%) of such tract's allocated share of the cost of drilling, testing, and completing such well.

The risk charge does not apply to “equipping or operating expenses.”

The risk charge is exclusive of amounts the drilling owner remits to the non-participating owner for the benefit of the nonparticipating owner’s royalty and overriding royalty.



OWNERS NOT NOTIFIED

If the drilling owner chooses not to send a risk charge notice or fails to send the risk charge notice, then the drilling owner has same rights of recoupment against that owner's interest BUT CANNOT ASSESS THE RISK CHARGE.

OWNERS NOT NOTIFIED AND UNLEASED OWNERS

- A nonparticipating owner that has not received risk charge notice, and unleased owner Can only be charged their share of costs and operating expenses.
- NO RISK CHARGE
- Once the nonparticipating owner's or unleased landowner's share of Unit Well Costs and Operating Expenses have been recovered from unit production, it becomes entitled to begin to share in unit production.

Drilling Owner's Obligation for Payment of Royalty and Overriding Royalty

AS OF 2012 REVISION (WITH 2022 UPDATES)

- During the recoupment period (costs and 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 the proceeds **from the sale of disposition of** production due to the lessor royalty owner under the terms of the contract or agreement creating the royalty between the **lessor** royalty owner and the nonparticipating owner reflected of record at the time of the **risk charge notice**.

2022 REVISION

Information the Nonparticipating Owner Must Provide the Drilling Owner

- As of 2022 revision, to receive such royalties or overriding royalties the Nonparticipating Owner Must Provide the Drilling Owner, BOTH:
 - (1) A true and complete, or redacted, copy of the mineral lease or other agreement creating any lessor royalty or overriding royalty for which the nonparticipating owner is entitled to receive a portion of the proceeds from the sale or other disposition of production.

2022 REVISION

Information the Non-Participating Owner Must Provide the Operator

- (2) A sworn statement of the ownership of the nonparticipating owner as to each tract embraced within the unit in which the nonparticipating owner has an interest and the amounts of the lessor royalty and overriding royalty burdens for which the non-participating owner is entitled to receive a portion of the proceeds from the sale or other disposition of production.
 - **At its discretion, can supply a title opinion or portion of title opinion**
 - **But title opinion must still be accompanied by the sworn statement**

2022 REVISION

Drilling Owner's Obligation for Payment of Royalty and Overriding Royalty

- A nonparticipating owner that has received from the drilling owner proceeds for the benefit of a royalty owner, based only on the information furnished pursuant to Subitem (gg) of this Item, **shall indemnify and hold harmless the drilling owner** from and against any claims asserted against the drilling owner related to any amounts paid to the nonparticipating owner.
- The nonparticipating owner shall also **restore to the drilling** owner any amounts paid by the drilling owner to the nonparticipating owner in reliance on the **information** furnished pursuant to Subitem (gg) of this Item, if and to the extent **determined to be incorrect**.

2022 REVISION

Drilling Owner's Obligation for Payment of Royalty and Overriding Royalty

- Nothing in the statute relieves any lessee of its obligations to pay royalties due under any lease.
- The drilling owner's obligation to pay the nonparticipating owner's royalty owners in no way creates an obligation, duty, or relationship between the drilling owner and any person to whom the nonparticipating owner is liable, contractually or otherwise.

Drilling Owner's Obligation for Payment of Royalty and Overriding Royalty

- In the event of nonpayment of royalty or overriding royalty, the lessor royalty and overriding royalty owners may provide written notice of such failure to the nonparticipating owner and the drilling owner using the same procedure (and having same remedies) provided in the Mineral Code (LSA RS 31:133-144 and 31:212.21-23).
- **2022 Revision:** The written notice provided to the drilling owner by the lessor royalty owner or overriding royalty owner shall include a true and complete, or redacted, copy of the mineral lease or other agreement creating any lessor royalty or overriding royalty.
- However, if the drilling owner provides sufficient proof of payment of the royalties to the nonparticipating owner, then the lessor royalty and overriding royalty owner shall have no cause of action against the drilling owner for nonpayment.

Drilling Owner's Obligation for Payment of Royalty and Overriding Royalty

- **OVERRIDING ROYALTY**

- The statute contains revisions regarding the drilling owner's obligations to pay overriding royalty owner amounts.
- To spare you the gory details, the bottom line is that the drilling owner must pay the nonparticipating owner's overriding royalty, but only to the extent that the nonparticipating owner's weighted average total lease burdens do not exceed the drilling owner's weighted average total lease burdens

2022 REVISION

Changes in Ownership

- No change or division of the ownership of a nonparticipating owner shall be binding upon the drilling owner for the purpose of paying to the nonparticipating owner for the benefit of its lessor royalty owner or overriding royalty owner until such new nonparticipating owner acquiring has furnished the drilling owner with a certified copy of the instrument constituting the chain of title from the original nonparticipating owner.



2022 REVISION

Recovering the Costs of Securing a Title Opinion

- On a tract in which the drilling owner is remitting royalties to the nonparticipating owner for the benefit of his lessor royalty owner, the drilling owner may charge actual reasonable costs incurred in obtaining the title examination as a cost recoverable by the drilling owner out of the tract's allocable share of production.
- In such case, the drilling owner shall provide the nonparticipating owner applicable excerpts of such title opinion.



2022 REVISION

SUBSEQUENT UNIT OPERATIONS

- The operator is now able to use the risk charge process for “subsequent unit operations.”
- The risk charge for “subsequent unit operations” is 100% of each tract’s allocated share of the actual reasonable expenditures, including a charge for supervision, regardless of whether the wellbore on which such operations were conducted is a unit well, alternate unit well, substitute unit well, or cross-unit well.

SUBSEQUENT UNIT OPERATIONS CONTENT OF NOTICE

- A detailed description identifying:
 - the well to which the subsequent unit operation relates,
 - the work associated therewith, and
 - the new location and objective depth of the well if changed as a result of such work.
- A copy of the order of the commissioner creating the drilling unit
- An AFE that shall include a detailed estimate, or the actual amount, of the cost of conducting the subsequent unit operation
- An estimate of the notified owner's approximate percentage of well participation.
- A copy of all available logs, core analysis, production data, and well test data with respect to the well that has not been made public.



SUBSEQUENT UNIT OPERATIONS

- If on the date of the subsequent unit operation notice there are still amounts uncollected on a risk charge from a nonparticipating owner for the drilling or previous operation on the wellbore, the drilling owner may recoup a risk charge from that nonparticipating owner on the costs of the subsequent unit operation only if the drilling owner sends that nonparticipating owner a notice of the subsequent unit operation.

SUBSEQUENT UNIT OPERATIONS

- The subsequent unit operations notice may offer that nonparticipating owner the opportunity to participate in the subsequent unit operation upon payment to the drilling owner, within sixty days of the date of receipt of the notice, of the nonparticipating owner's entire outstanding balance due for all previous operations on the wellbore, including any amounts uncollected on a risk charge.

SUBSEQUENT UNIT OPERATIONS

- If the drilling owner sends the notice, it may, in addition to recouping the costs of a subsequent unit operation, recoup a risk charge (100%) on the costs of the subsequent unit operation from the nonparticipating owner's portion if it fails to elect timely to participate in the subsequent unit operation, or if it fails to pay timely the entire outstanding balance due for all previous operations on the wellbore, or if it fails to pay timely its share of the estimated costs of the subsequent unit operation determined by the AFE.

Definitions

- **Subsequent Unit Operation**

- A recompletion, rework, deepening, sidetrack, or extension conducted within the unitized interval for a unit or units created under R.S. 30:9(B).

Definitions

- **Deepening**

- An operation whereby an existing wellbore serving as a unit well, alternate unit well, substitute unit well, or cross-unit well is extended to a point within the same unit and unitized interval beyond its previously drilled total vertical depth.

Definitions

- **Extension**

- An operation related to a horizontal well whereby a lateral is drilled in the same unitized interval to a greater total measured depth or extent than the lateral was drilled pursuant to a previous proposal.

Definitions

- **Recompletion**

- An operation to attempt a completion in a portion of the unitized interval in the existing wellbore different from the initial completion in the unitized interval.

Definitions

- **Rework**

- an operation conducted in the wellbore after it is initially completed in the unitized interval in a good faith effort to secure, restore, or improve production in a stratum within the unitized interval that was previously open to production in that wellbore, including re-perforating, hydraulic fracturing and re-fracturing, tubing repair or replacement, casing repair or replacement, squeeze cementing, setting bridge plugs, and any essential preparatory steps.
- “Rework” does not include routine maintenance such as acidizing, sand or paraffin removal, repair, or replacement of downhole equipment such as rods, pumps, packers, or other mechanical devices.

Definitions

- **Sidetrack**

- The intentional deviation of an existing wellbore serving as a unit well, alternate unit well, or substitute unit well from its actual or permitted bottom hole location within that unit and unitized interval to a different bottom hole location within the same unit and unitized interval or done to drill around junk in the hole or to overcome other mechanical difficulties in order to reach the permitted bottom hole location.

Definitions

- **Unitized Interval**

- The subsurface interval defined in the office of conservation order creating the unit or units that the existing wellbore is serving as a unit well, alternate unit well, substitute unit well, or cross-unit well.

BUT WAIT!!

The story has not ended.

- **2023 House Bill 590 was Representative Larry Bagley**
- **Has been referred to the House Committee on Natural Resources and Environment**

2023 HB 590

- HB 590 requires the drilling owner to **directly** pay the nonparticipating owner's lessor royalty and overriding royalty owners.
 - Even the lessor royalty owners of an "owner not notified"
- Does not absolve the nonparticipating owner of liability for unpaid royalties
- But removes the nonparticipating owner as the conduit and buffer for the third party royalty owners
- Does not remove proof of title information from 2022 revision



2023 HB 590

- LOGA has come out against this bill
- Goes against many of the goals that the legislature set forth for the Risk Fee Committees
- Relieves the nonparticipating owner from much of the responsibility associated with owning a working interest in a unit, and forces the drilling owner to work directly with lessor royalty owners with whom it has no contractual privity.
- Unintended consequences for drilling owners in terms of administrative headaches, funds in suspense for lack of information, and potential litigation.
- Puts accounting and distribution burden on the drilling owner



2023 HB 590

STAY TUNED!



THANK YOU!!



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