

# FORCED INTO FRACKING: MANDATORY POOLING IN OHIO

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## I. INTRODUCTION

Ohio is in the midst of a shale natural gas boom.<sup>1</sup> The production of shale natural gas through the use of hydraulic fracturing is taking place in the Marcellus and Utica Shale regions that encompass the eastern portions of Ohio. Many landowners in those regions are eagerly participating in the production of the shale natural gas by leasing their tracts of land to oil and gas developers.<sup>2</sup> However, there are also landowners who are opposed to participating in the production of shale natural gas due to the risks associated with hydraulic fracturing.<sup>3</sup> Despite this opposition to hydraulic fracturing, might these landowners be forced to participate in the shale natural gas production anyway?

The answer to the question can be found in a set of laws that the Ohio General Assembly enacted to respond to an oil boom in the 1960s.<sup>4</sup> Ohio Revised Code § 1509.27 provides a mechanism to force Ohio landowners to participate in oil and gas development without their consent.<sup>5</sup> This process is known as “mandatory pooling.”<sup>6</sup> Mandatory pooling is an anti-holdout law that ensures the efficient production of natural resources.<sup>7</sup> In order to develop oil and gas in Ohio, one must own enough land to exceed

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<sup>1</sup> See, e.g., Ryan Dezember, *Ohio Shale Sparks Deals*, WALL ST. J., Sept. 27, 2011, at C9; Dan Gearino & Spencer Hunt, *Utica Shale Producing but What’s the Ceiling?*, COLUMBUS DISPATCH, May 17, 2013, at A1.

<sup>2</sup> See Mary Vanac, *Farmers in Ohio Divided on ‘Fracking,’* COLUMBUS DISPATCH, Feb. 2, 2013, at D1.

<sup>3</sup> See *id.*; see also Spencer Hunt, *No to ‘Fracking’ Doesn’t Mean No*, COLUMBUS DISPATCH, July 29, 2012, at A1; Julie Carr Smyth, *Ohio Laws Allow Drilling Even Where Owners Object*, CHARLESTON GAZETTE (W. Va.), Apr. 23, 2012, at 9A.

<sup>4</sup> See J. Richard Emens & John S. Lowe, *Ohio Oil and Gas Conservation Law—The First Ten Years (1965–1975)*, 37 OHIO ST. L.J. 31, 35 (1976).

<sup>5</sup> OHIO REV. CODE ANN. § 1509.27 (West Supp. 2013).

<sup>6</sup> See *id.*

<sup>7</sup> See *infra* Part II.C.3.

the state's minimum acreage requirements.<sup>8</sup> If landowners, or oil and gas developers, fail to own or control the required acres and are unable to form voluntary agreements with adjoining landowners, they may apply to the Ohio Department of Natural Resource's Division of Oil and Gas Resources (Division of Oil and Gas) for a mandatory pooling order.<sup>9</sup> After a lengthy hearing process and, if all the required conditions are satisfied, the Chief of the Division of Oil and Gas (Chief) may issue a mandatory pooling order.<sup>10</sup> The Chief's order would require the landowners of the adjoining tracts of land to participate in the oil and gas development.<sup>11</sup> Therefore, the short answer to the question posed above is yes. Through the issuance of a mandatory pooling order, Ohio law may force Ohio landowners to participate in the shale natural gas development without their consent and over their opposition to hydraulic fracturing.

The mandatory pooling process has rarely been used since it was enacted in 1965. However, in the past few years there has been an increased use of mandatory pooling. As the shale natural gas boom continues, mandatory pooling orders will likely be utilized more frequently.<sup>12</sup> In light of the likely increased use of mandatory pooling, it is vital to ensure that § 1509.27—the statute that allows mandatory pooling—adequately responds to the demands and risks posed by hydraulic fracturing and is equitable to both those who wish to develop shale natural gas and those who wish to refrain due to the risks of hydraulic fracturing.

When the Ohio General Assembly enacted the mandatory pooling law in 1965, the legislature was responding to the demands posed by traditional vertical drilling and migratory black oil.<sup>13</sup> However, shale natural gas is the natural resource driving today's demands. Unlike migratory black oil, shale natural gas is nonmigratory and is extracted using hydraulic fracturing.<sup>14</sup> The nonmigratory property of shale gas and its extraction

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<sup>8</sup> OHIO REV. CODE ANN. § 1509.24 (West Supp. 2013).

<sup>9</sup> *Id.* § 1509.27.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> See Hunt, *supra* note 3, at A4; *Mandatory Pooling*, OHIO DEP'T OF NATURAL RES. DIV. OF OIL & GAS, <http://oilandgas.ohiodnr.gov/Industry/Mandatory-Pooling> (last visited Mar. 4, 2014).

<sup>13</sup> See Emens & Lowe, *supra* note 4, at 36.

<sup>14</sup> Extracting shale natural gas requires a two-step process:

To start, a production well is drilled thousands of feet downward and then gradually angled out horizontally through the shale deposit. The

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method pose different demands and create new concerns compared to those driving the creation of the oil and gas conservation laws of the 1960s. As a result, many of Ohio's laws, including § 1509.27, became outdated. For this reason, the Ohio General Assembly made substantial changes to the original oil and gas conservation laws over the past several years.<sup>15</sup> However, the language of § 1509.27 has substantively stayed the same.

The current language of § 1509.27 is not equitable for landowners subject to a mandatory pooling order. After being forced to participate in the drilling unit, the landowners will receive their pro rata share of the production minus the costs of production and a risk penalty.<sup>16</sup> The risk penalty is assessed against the nonconsenting landowner to reward the oil and gas developer for taking the risks associated with drilling. The risk penalty can be up to 200% of the costs of production.<sup>17</sup> Thus, under Ohio's approach to mandatory pooling, landowners who do not consent to the development of shale natural gas can be forced to participate and pay a penalty.

This Comment explains Ohio's approach to mandatory pooling. There are different approaches to mandatory pooling. The approaches can be grouped into three categories. The first approach is the free-ride approach, where the nonconsenting owner will only be held liable for the costs of production if the well operation is successful.<sup>18</sup> The second approach is the risk-penalty approach—Ohio's current approach to mandatory pooling—which is where the nonconsenting owner is subject to a penalty to reward the well operator for taking the risk of drilling the well if the well is successful.<sup>19</sup> The third approach is the enumerated options approach, by which nonconsenting owners can choose an alternative from a list of options that best fits their own specific circumstances upon receiving a

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well is drilled horizontally to maximize the ability to capture natural gas once the shale is hydraulically fractured.

After the well is drilled, a mixture of water, sand and chemical additives is injected at very high pressure to fracture the shale. This part of the process [is] called hydraulic fracturing . . . .

*Drilling for Natural Gas in the Marcellus and Utica Shales: Environmental Regulatory Basics*, OHIO EPA 1 (Nov. 2012), <http://www.epa.ohio.gov/portals/0/general%20pdfs/generalshale711.pdf>.

<sup>15</sup> See *infra* Part II.C.2

<sup>16</sup> OHIO REV. CODE ANN. § 1509.27 (West Supp. 2013).

<sup>17</sup> *Id.*

<sup>18</sup> See *infra* Part IV.A.

<sup>19</sup> See *infra* Part IV.B.

mandatory pooling order.<sup>20</sup> The enumerated options approach is the most equitable approach for all parties involved because it provides nonconsenting owners with multiple alternatives to choose from after receiving a mandatory pooling order and, at the same time, preserves the oil and gas developer's ability to pool tracts of land to form a drilling unit.<sup>21</sup>

Before analyzing the alternative approaches to mandatory pooling in depth, this Comment will first discuss the history and rationale behind mandatory pooling laws<sup>22</sup> and provide an explanation of Ohio's current approach to mandatory pooling.<sup>23</sup> Next, this Comment will discuss the constitutionality of mandatory pooling laws.<sup>24</sup> Finally, after analyzing the alternative approaches to mandatory pooling, this Comment will propose that the Ohio General Assembly should adopt the enumerated options approach.<sup>25</sup> The Ohio General Assembly must replace its risk-penalty approach to mandatory pooling and adopt an enumerated options approach because it will provide more equitable alternatives to Ohio landowners who are subject to a pooling order while maintaining the main purposes for mandatory pooling laws.

## II. OVERVIEW OF OHIO'S OIL AND GAS LAW

### A. *Historical Explanation of Ohio's Early Oil and Gas Laws*

In 1814, oil was first discovered in Ohio<sup>26</sup> and, for over a century thereafter, the production of oil and gas was generally governed by the common law rule of capture.<sup>27</sup> Oil and gas are contained in large pools below the surface that are often stretched over many different tracts of land.<sup>28</sup> Commonly, multiple landowners own these tracts and each landowner has an interest in the common pool of oil and gas.<sup>29</sup> Thus, the common law rule of capture was a mechanism to settle disputes among adjoining landowners in regard to legal title of the oil because "[o]il and

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<sup>20</sup> See *infra* Part IV.C.

<sup>21</sup> See *infra* Part V.

<sup>22</sup> See *infra* Part II.A–B.

<sup>23</sup> See *infra* Part II.C.1.

<sup>24</sup> See *infra* Part III.

<sup>25</sup> See *infra* Part V.

<sup>26</sup> See Emens & Lowe, *supra* note 4, at 33.

<sup>27</sup> *Id.* at 32–33.

<sup>28</sup> BRUCE M. KRAMER & PATRICK H. MARTIN, *THE LAW OF POOLING AND UNITIZATION* 2-1 (3d ed. 2010).

<sup>29</sup> *Id.* at 2-5.

gas can migrate from place to place underground, so that a well drilled on one property may drain oil and gas from under neighboring land.”<sup>30</sup> The rule of capture provides that oil and gas are “mineral[s], and while [they are] in the earth [they] form[] a part of the realty, and when [they] reach[] a well, and [are] produced on the surface, [they] become[] personal property, and belong[] to the owner of the well.”<sup>31</sup> Therefore, according to the rule of capture, “[w]hatever gets into the well belongs to the owner of the well, no matter where it came from.”<sup>32</sup>

The rule of capture focuses on the oil and gas that is captured in a well rather than the oil and gas below the ground not yet captured. The first recognition of a right to the minerals does not occur until the minerals are extracted from the ground.<sup>33</sup> Thus, under the rule of capture, title to the oil and gas under a tract of land does not vest in an owner until it is extracted from the land.<sup>34</sup>

The rule of capture fails to protect a right in the oil and gas under one’s tract of land, causing harsh practical effects for landowners. Landowners face the choice to either immediately commence drilling on their tracts of land to gain title in the oil or face the possibility of the oil escaping and an adjoining landowner capturing the oil. The fact that “[t]he right to drill and produce oil on one’s own land is absolute,” as long as it is done so in a legal manner,<sup>35</sup> provides a remedy to the rule of capture, which also contributes to the dilemma of landowners. On one hand, courts found the absolute right to drill on one’s land a sufficient remedy compared to an injunction or accounting because the owner could simply drill a well to offset the production of the adjoining landowner.<sup>36</sup> On the other hand, a landowner needed to rush the decision of whether to drill a well over a common pool of oil because drilling an offset well was the recognized remedy. Drilling an offset well became the primary means for landowners to avoid the harsh effects of the rule of capture.<sup>37</sup>

As a result, landowners drilled an abundance of offset wells in Ohio. Offset wells are wells drilled on one tract of land to offset the well drilled

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<sup>30</sup> See Emens & Lowe, *supra* note 4, at 32.

<sup>31</sup> Kelly v. Ohio Oil Co., 49 N.E. 399, 399 (Ohio 1897).

<sup>32</sup> *Id.* at 401.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> KRAMER & MARTIN, *supra* note 28, at 2-4.

on an adjoining tract of land over a common pool of oil or gas.<sup>38</sup> The rule of capture and the abundance of offset wells had several negative implications. First, one implication was that Ohio's land became over drilled.<sup>39</sup> Landowners drilled many wells to extract oil and gas from a common pool. These active wells over a common pool were often inefficient because a smaller number of wells would have been sufficient to effectively extract the oil or gas from the common pool. Second, the rule of capture led to a premature dissipation of natural reservoir energy.<sup>40</sup> In order to protect their mineral rights, adjoining landowners raced one another in extracting the oil or gas from the common pool. Thus, despite what might have been in the best interests of landowners and the environment, landowners could not afford to wait and preserve the minerals under their tracts of land. Finally, the rule of capture failed to adequately protect the correlative rights of landowners.<sup>41</sup>

Due to the negative implications of the rule of capture and its harsh practical effects on landowners, the rule of capture no longer governs the rights to interests in oil and gas in Ohio. Ohio courts superseded the rule of capture in 1984.<sup>42</sup> The oil and gas conservation laws enacted in 1965 provided the statutory basis for the departure from the rule of capture.<sup>43</sup>

#### *B. Response to the Rule of Capture: Ohio's Oil and Gas Conservation Laws*

In 1896, Ohio was the nation's leader in oil production.<sup>44</sup> However, Ohio's oil production declined significantly in the six subsequent decades.<sup>45</sup> During the years of the decline in production, the Ohio legislature largely left Ohio's laws related to the production of oil and gas untouched.<sup>46</sup> The decline lasted until the early 1960s when Ohio experienced an oil boom that, at its peak, increased oil production approximately 300% from that prior to the oil boom.<sup>47</sup> Also during this

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<sup>38</sup> *Id.* at 2-1.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.* at 2-17.

<sup>42</sup> *Schrimsher Oil & Gas Exploration v. Stoll*, 484 N.E.2d 166, 166 (Ohio Ct. App. 1984).

<sup>43</sup> See *Emens & Lowe*, *supra* note 4, at 32.

<sup>44</sup> *Id.* at 33.

<sup>45</sup> *Id.*

<sup>46</sup> *Id.* at 33-34.

<sup>47</sup> *Id.* at 34.

period, the Ohio Legislative Service Commission estimated that “over three-fourths of Ohio [was] leased for oil and gas.”<sup>48</sup> Thus, after many years of decline in the oil and gas industry, Ohio once again became “the hottest subject in the oil industry.”<sup>49</sup>

In 1965, after recognizing that the rule of capture was inadequate to meet the demands of a booming oil and gas industry, the Ohio General Assembly enacted a comprehensive oil and gas conservation law.<sup>50</sup> “[T]he purpose of a conservation statute is both to further the public’s interest in conservation and to protect the property rights of operators and landowners.”<sup>51</sup> The legislature designed the 1965 law to combat the main problems of the common law rule of capture: over drilling, premature dissipation of energy reservoirs, and failure to protect the correlative rights of landowners. The main focus of the law was “toward the prevention of physical and economic waste.”<sup>52</sup> Although the law was an improvement over the rule of capture, critics pointed to several flaws in the legislation. Some of the major criticisms were that the law failed to achieve the maximum conservation and “failed to provide fully for the protection of correlative rights.”<sup>53</sup>

The 1965 law is the basis for the current laws governing Ohio’s oil and gas conservation and production. Ohio’s oil and gas conservation laws are codified in chapter 1509 of the Ohio Revised Code.<sup>54</sup> Prior to analyzing Ohio’s mandatory pooling law,<sup>55</sup> it is first necessary to describe the key terms and components of the law.

Portions of chapter 1509 of the Ohio Revised Code provide a mechanism for landowners to pool tracts of land together in order to form a drilling unit to extract oil from a common pool.<sup>56</sup> The major provisions and definitions of key terms make it evident that chapter 1509 responds to the shortfalls of the common law rule of capture. A “pool” is an “underground reservoir containing a common accumulation of oil or gas,

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<sup>48</sup> *Id.* (quoting OHIO LEGISLATIVE SERV. COMM’N, Staff Research Rep. No. 63, OIL AND GAS LAW IN OHIO 13 (1965) [hereinafter 1965 OIL AND GAS LAW REP.]).

<sup>49</sup> *Id.* (quoting 1965 OIL AND GAS LAW REP. at 13).

<sup>50</sup> *Id.* at 35.

<sup>51</sup> *Id.* at 32.

<sup>52</sup> *Id.* at 37.

<sup>53</sup> *Id.*

<sup>54</sup> OHIO REV. CODE ANN. § 1509 (West Supp. 2013).

<sup>55</sup> *Id.* § 1509.27.

<sup>56</sup> *Id.* §§ 1509.26–27.

or both.”<sup>57</sup> This definition highlights the main issue for the rule of capture: Oil and gas are not confined to an area under a single tract of land,<sup>58</sup> but they may be in a large pool under many tracts of land.

In order to promote efficient production of oil and gas, those interested in extracting oil and gas must first form a drilling unit.<sup>59</sup> A “drilling unit” is “the minimum acreage on which one well may be drilled.”<sup>60</sup> A drilling unit prevents an abundance of offset wells because a well cannot be drilled within a specified distance from an existing well.<sup>61</sup> Furthermore, chapter 1509 explicitly protects the correlative rights of landowners. An owner’s<sup>62</sup> “correlative rights” refer to “the reasonable opportunity to every person entitled thereto to recover and receive the oil and gas in and under the person’s tract or tracts . . . without having to drill unnecessary wells or incur other unnecessary expense.”<sup>63</sup>

Moreover, Ohio’s oil and gas laws provide a detailed process for forming a drilling unit in order to commence drilling.<sup>64</sup> Persons interested in forming a drilling unit to drill a well, whether it be drilling a new well or altering an existing well, must first obtain permission from the Chief.<sup>65</sup> The application process to obtain a permit is quite lengthy. Among the many steps in the application process, the applicant must specify those with a royalty interest<sup>66</sup> in the proposed drilling unit<sup>67</sup> and the proposed depth of the well.<sup>68</sup> The proposed depth of the well is necessary to determine if the application satisfies the minimum acreage requirements.<sup>69</sup> The Ohio General Assembly gave the Division of Oil and Gas the

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<sup>57</sup> *Id.* § 1509.01(E).

<sup>58</sup> A “tract of land” is “a single, individually taxed parcel of land appearing on the tax list.” *Id.* § 1509.01(J).

<sup>59</sup> *Id.* § 1509.25.

<sup>60</sup> *Id.* § 1509.01(G).

<sup>61</sup> *Id.* § 1509.06.

<sup>62</sup> An “owner” is “the person who has the right to drill on a tract [of land] or drilling unit, to drill into and produce from a pool, and to appropriate the oil or gas produced therefrom either for the person or for others.” *Id.* § 1509.01(K).

<sup>63</sup> *Id.* § 1509.01(I).

<sup>64</sup> *Id.* § 1509.06.

<sup>65</sup> *Id.* § 1509.05.

<sup>66</sup> A “royalty interest” is “the fee holder’s share in the production from a well.” *Id.* § 1509.01(L).

<sup>67</sup> *Id.* § 1509.06(A)(3).

<sup>68</sup> *Id.* § 1509.06(A)(6).

<sup>69</sup> *Id.* § 1509.06(A)(1)(a).



discretion to establish the minimum acreage requirements for drilling units.<sup>70</sup> The minimum acreage requirements are dependent on the proposed depth of the well—the greater the depth of the proposed well, the larger the minimum acreage requirements necessary to obtain a permit.<sup>71</sup> In addition to establishing the minimum acreage required for the drilling unit itself, the proposed depth of the well determines the minimum distance it must be from an existing well and the outer boundaries of the drilling unit.<sup>72</sup> Thus, this process is an attempt to ensure that the Division of Oil and Gas is aware of individuals who have an interest in the common pool being drilled in a specified area and to prevent an abundance of wells within a specified area.

Due to the fact that the Chief has the authority to issue drilling permits and pooling orders,<sup>73</sup> the Ohio Revised Code provides a specific appeals process for those who may be adversely affected by a ruling. The initial appeals process provides that a party who is “adversely affected by an order by the chief of the division of oil and gas resources management may appeal to the oil and gas commission.”<sup>74</sup> However, if a party is not satisfied with the administrative ruling from the oil and gas commission, the party may appeal that order to the Court of Common Pleas of Franklin County, Ohio.<sup>75</sup>

### C. Ohio’s Mandatory Pooling Law

#### 1. Pooling Tracts of Land to Form a Drilling Unit

A landowner who does not control the amount of acres specified by the Ohio Revised Code to form a drilling unit may “pool” adjoining tracts of land.<sup>76</sup> “Pooling” is “the bringing together of two or more small or

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<sup>70</sup> *Id.* § 1509.24.

<sup>71</sup> See OHIO ADMIN. CODE 1501:9-1-04(C) (2011). A shale gas well is 5,000 to 8,000 feet below the surface. See *The Facts About Hydraulic Fracturing*, OHIO DEP’T OF NATURAL RES., <http://oilandgas.ohiodnr.gov/portals/oilgas/pdf/Facts-about-HFracturing.pdf> (last visited Mar. 4, 2014). Thus, based on the depth of a shale gas well, the minimum acreage required is forty acres. See OHIO ADMIN. CODE 1501:9-1-04(C).

<sup>72</sup> OHIO ADMIN. CODE 1501:9-1-04(C).

<sup>73</sup> See *infra* Part II.C.

<sup>74</sup> OHIO REV. CODE ANN. § 1509.36 (West Supp. 2013). The oil and gas commission is a statutorily mandated five-member commission. *Id.* § 1509.35(A) (West Supp. 2013). The governor appoints the five members according to specific criteria contained within the statute. See *id.*

<sup>75</sup> *Id.* § 1509.37 (West Supp. 2013).

<sup>76</sup> *Id.* § 1509.27.

irregularly shaped tracts of land to form a” drilling unit.<sup>77</sup> Ohio laws provide two mechanisms for pooling tracts of land to form a drilling unit: voluntary pooling agreements<sup>78</sup> and mandatory pooling orders.<sup>79</sup>

Ohio Revised Code § 1509.26 allows landowners to form voluntary pooling agreements in order “to form a drilling unit which conforms to the minimum acreage and distance requirements” mandated by Ohio law.<sup>80</sup> The only recognized stipulation to forming a voluntary pooling agreement is that the agreement must be in writing and filed with the application for a drilling permit.<sup>81</sup> Voluntary pooling agreements are the preferred method to form a drilling unit—when an individual tract of land is of insufficient size—because voluntary agreements require fewer government resources than mandatory pooling orders require<sup>82</sup> and consenting parties form the agreements in the marketplace.

If a voluntary pooling agreement cannot be formed, the second option to form a drilling unit is to apply for a mandatory pooling order.<sup>83</sup> The Chief issues a mandatory pooling order, which requires nonconsenting landowners to join a drilling unit.<sup>84</sup> Unlike voluntary pooling agreements, mandatory pooling orders do not reflect agreements that would be made in a marketplace and are not made by consenting landowners. As a result, the process and criteria that must be satisfied before obtaining a mandatory pooling order are more stringent.

Two conditions must be satisfied before an applicant becomes eligible to apply for a mandatory pooling order from the Division of Oil and Gas. First, the applicant’s tract of land must be “of insufficient size or shape to meet the requirements for drilling a well” on the tract of land.<sup>85</sup> Second,

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<sup>77</sup> A. Allen King, *The New Property*, 46 MICH. L. REV. 311, 313 (1948). *Pooling* and the term *unitization* are often used together, but each has a separate meaning that is necessary to distinguish. Unlike the term *pooling*, *unitization* refers to a “consolidation or merger of all of the interests in the [common] pool” of oil or gas. *Id.* Thus, these terms differ in that pooling seeks to join one or several tracts of land to form a drilling unit, whereas unitization is joining all interests over a pool.

<sup>78</sup> OHIO REV. CODE ANN. § 1509.26 (West Supp. 2013).

<sup>79</sup> *Id.* § 1509.27 (West Supp. 2013).

<sup>80</sup> *Id.* § 1509.26.

<sup>81</sup> *Id.*

<sup>82</sup> *Id.* § 1509.27.

<sup>83</sup> *Id.* The well operator must have formed at least 90% of the drilling unit through voluntary agreements. *Mandatory Pooling*, *supra* note 12.

<sup>84</sup> OHIO REV. CODE ANN. § 1509.28 (West Supp. 2013).

<sup>85</sup> *Mandatory Pooling*, *supra* note 12.

“the owner [of the tract of land, who also is the owner of the mineral interest,] has been unable to form a drilling unit [under a voluntary agreement] on a just and equitable basis.”<sup>86</sup> These two conditions indicate that mandatory pooling orders should only be considered by the Division of Oil and Gas when the owner of the tract of land has no other alternatives—the owner cannot drill on the owner’s land because the land is of an insufficient size, and the owner has failed, despite just and equitable efforts, to form a voluntary pooling agreement under Ohio Revised Code § 1509.26 with adjoining landowners.<sup>87</sup> Thus, the owner will only be able to apply for a mandatory pooling order after satisfying these two conditions.

Once the owner files the application, the Ohio Revised Code provides steps to ensure that the owners of tracts of land will be included in the drilling unit under the mandatory pooling order so as to afford them their due process rights.<sup>88</sup> First, the law requires that the Chief notify<sup>89</sup> all owners whose land will potentially be included in the proposed drilling unit under the mandatory pooling order and inform them of a right to a hearing.<sup>90</sup> Providing notification and a right to a hearing allows landowners who do not wish to be included in a drilling unit the opportunity to present information to the Chief prior to the Chief’s final determination on the order.

Once the hearing takes place or the landowners decline a meeting or fail to respond to the notification,<sup>91</sup> the Chief must make a determination on the application for a mandatory pooling order. The Chief shall approve the application and issue a mandatory pooling order only if two conditions are satisfied. The first condition is that the applications for a mandatory pooling order and the drilling permit are in proper form.<sup>92</sup> The second—and most critical—condition is that a mandatory pooling order “is necessary to protect correlative rights or to provide effective development,

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<sup>86</sup> *Id.*

<sup>87</sup> OHIO REV. CODE ANN. § 1509.28 (West Supp. 2013).

<sup>88</sup> *See infra* Part III.

<sup>89</sup> Mail notice is the proper form of notification that the Chief must provide to all landowners potentially subject to the mandatory pooling order. OHIO REV. CODE ANN. § 1509.27 (West Supp. 2013).

<sup>90</sup> *Id.*

<sup>91</sup> The Chief must allow thirty days to pass after mailing the notification to the landowners before the Chief is able to make a ruling without a hearing. *Id.*

<sup>92</sup> *Id.*

use, or conservation of oil and gas.”<sup>93</sup> Without this condition, mandatory pooling orders may be deemed unconstitutional.<sup>94</sup> In addition, this factor promotes conservation and efficiency and protects correlative rights, which are the main purposes of the conservation laws.<sup>95</sup>

If the Chief determines that the two conditions for approving a mandatory pooling order are satisfied, the applicant will obtain a drilling permit and an order stating that the adjoining tracts of land identified in the application are to join the drilling unit.<sup>96</sup> The mandatory pooling order must contain several components that provide safeguards to the landowners subject to the order and account for the costs and production to the tracts of land in the drilling unit. The pooling order must designate the boundaries for the drilling unit and the proposed production site.<sup>97</sup> These requirements ensure that the production site is not located on the tracts of land pooled by the mandatory pooling order unless the landowners consent.<sup>98</sup> In addition, the order must “[a]llocate on a surface acreage basis a pro rata portion of the production to the owner of each tract pooled by the order” and “[s]pecify the basis upon which each owner of a tract pooled by the order shall share all reasonable costs and expenses of drilling and producing if the owner elects to participate in the drilling and operation of the well.”<sup>99</sup>

Once the Chief issues a mandatory pooling order, the landowners subject to the order have two options. The first option is that the landowner may elect to participate in the drilling unit.<sup>100</sup> If a landowner makes this election, the landowners must contribute, up front, the portion of reasonable costs and expenses for drilling and production as specified in the mandatory pooling order.<sup>101</sup> Thus, the landowner essentially becomes a working interest<sup>102</sup> owner and shares in the risks associated with the drilling operations.

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<sup>93</sup> *Id.*

<sup>94</sup> *See infra* Part III.

<sup>95</sup> *See supra* Part II.B.

<sup>96</sup> OHIO REV. CODE ANN. § 1509.27 (West Supp. 2013).

<sup>97</sup> *Id.* § 1509.27(A)–(B).

<sup>98</sup> *Id.* § 1509.27.

<sup>99</sup> *Id.* § 1509.27(D)–(E).

<sup>100</sup> *Id.* § 1509.27(E).

<sup>101</sup> *Id.*

<sup>102</sup> A working interest contains “the right to work on the leased property to search, develop, and produce oil and gas, as well as the obligation to pay all costs.” BLACK’S LAW DICTIONARY 1745 (9th ed. 2009).

The second option for a landowner subject to a mandatory pooling order is to elect not to participate in the drilling unit and be designated as a nonparticipating owner.<sup>103</sup> The well operator carries a nonparticipating owner through the production process, which means that nonparticipating owners do not have to contribute an upfront share of the costs and expenses for drilling and production.<sup>104</sup> However, a nonparticipating owner is subject to a risk penalty in order to be carried through the production process.

Under a risk-penalty system, assuming that the drilling unit's operations are successful and produce oil or gas,<sup>105</sup> the well operator holds the nonparticipating owner's share of production until the nonparticipating owner pays its share of the reasonable drilling costs and expenses.<sup>106</sup> In addition, the Chief may assess an "additional percentage of the share of costs" against the nonparticipating landowner to reward the operator for taking the risk of drilling a dry well.<sup>107</sup> The penalty assessed against the nonparticipating owner can exceed the nonparticipating owner's reasonable costs and expenses of production by up to 200%.<sup>108</sup> However, once the nonparticipating owner pays the reasonable costs, expenses, and penalty, the nonparticipating owner will "receive a proportionate share of the working interest in the well in addition to a proportionate share of the royalty interest, if any."<sup>109</sup>

## 2. *Recent Changes to Ohio Revised Code § 1509.27*

The Ohio General Assembly is amending many of the oil and gas conservation laws originally enacted after the oil boom in the 1960s<sup>110</sup> in response to the new challenges and demands of the hydraulic fracturing industry. Since 2010, the Ohio General Assembly has enacted two laws

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<sup>103</sup> OHIO REV. CODE ANN. § 1509.27 (West Supp. 2013).

<sup>104</sup> *See id.*

<sup>105</sup> Under a risk-penalty system, if a dry well is drilled, the nonparticipating owner does not have to pay the reasonable costs and expenses for drilling the dry well. *See* Jamison Cocklin, *Landowners Face Challenges with New Leasing Rules*, YOUNGSTOWN VINDICATOR April 28, 2013, at A1, A4. *See also* JOHN S. LOWE ET AL., CASES AND MATERIALS ON OIL AND GAS LAW 436 (6th ed. 2013) (providing that the developing party assumes all of the risk that the well will be dry).

<sup>106</sup> OHIO REV. CODE ANN. § 1509.27 (West Supp. 2013).

<sup>107</sup> *Id.*

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *See supra* Part II.B.

that made several substantial changes to Ohio Revised Code § 1509.<sup>111</sup> Some of the amendments to the laws added significant elements to the oil and gas laws, including regulating urbanized drilling<sup>112</sup> and addressing some of the environmental concerns with hydraulic fracturing.<sup>113</sup> However, the changes to Ohio Revised Code § 1509.27 were less substantial than to those to chapter 1509 overall.<sup>114</sup> Some of the more noteworthy changes to the mandatory pooling law and process pertain to the application process, the criteria in making a determination on a mandatory pooling application, and the liability for nonparticipating owners.

The 2010 amendments to the oil and gas laws increased the burden on the application process and limited the number of applications that can be filed in a single year. Applications for drilling permits that require a mandatory pooling order are assessed an additional fee of \$5,000.<sup>115</sup> Also, a person<sup>116</sup> cannot “submit more than five applications for mandatory pooling orders” in a single year.<sup>117</sup> The increased burden of the added application fee and the application limits will incentivize operators to form voluntary pooling agreements rather than utilize the mandatory pooling order process.

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<sup>111</sup> See S. Am. Sub. B. 315, 129th Gen. Assemb. (Ohio 2012), <ftp://server6.sos.state.oh.us/free/publications/SessionLaws/129/129SB-315.pdf>; S. Sub. B. 165, 128th Gen. Assemb. (Ohio 2010), <ftp://server6.sos.state.oh.us/free/publications/SessionLaws/128/128SB-165.pdf>.

<sup>112</sup> S. Sub. B. 165, 128th Gen. Assemb. (Ohio 2010), <ftp://server6.sos.state.oh.us/free/publications/SessionLaws/128/128SB-165.pdf>.

<sup>113</sup> See S. Am. Sub. B. 315, 129th Gen. Assemb. (Ohio 2012), <ftp://server6.sos.state.oh.us/free/publications/SessionLaws/129/129SB-315.pdf>.

<sup>114</sup> Although the bills enacted did not make substantial changes to Ohio Revised Code § 1509.27, multiple senators introduced a bill to the Ohio General Assembly that called for a repeal of § 1509.27 in its entirety. See S.B. 318, 129th Gen. Assemb., Reg. Sess. (Ohio 2012), [http://www.legislature.state.oh.us/BillText129/129\\_SB\\_318\\_I\\_Y.pdf](http://www.legislature.state.oh.us/BillText129/129_SB_318_I_Y.pdf). As of the time of this publication, the bill was not reported out of committee. See *Status Report of Legislation: 129th General Assembly—Senate Bills: SB 318*, LEGISLATIVE SERV. COMM’N, <http://lsc.state.oh.us/coderev/sen129.nsf/Senate+Bill+Number/0318?OpenDocument> (last visited Mar. 4, 2014).

<sup>115</sup> OHIO REV. CODE ANN. § 1509.06(G)(4) (West Supp. 2013).

<sup>116</sup> A “[p]erson” includes any political subdivision, department, agency, or instrumentality of this state; the United States and any department, agency, or instrumentality thereof; and any legal entity defined as a person under section 1.59 of the Revised Code.” *Id.* § 1509.01(T) (West Supp. 2013).

<sup>117</sup> *Id.* § 1509.27 (West Supp. 2013).

The 2010 amendments had subtly, but significantly changed the conditions that must be met before applying for a mandatory pooling order and the criteria that must be satisfied before the Chief can issue a mandatory pooling order. A mandatory pooling order applicant must be the owner of the tract of land that is of an insufficient size and shape to meet the requirements to form a drilling unit and the mineral interests in the land.<sup>118</sup> This requirement is a significant departure from the original statutory language, which only required the applicant to meet the definition of an “owner” as provided by Ohio Revised Code § 1509.01(K).<sup>119</sup> Under the 2010 amendments, the applicant must have the right to drill on the land, but must also own the right to the mineral interests.

In addition, the 2010 amendments to Ohio Revised Code § 1509.27 also changed the criteria that must be satisfied before the Chief can issue a mandatory pooling order. In order for the Chief to approve an application for a mandatory pooling order, all three interests—protecting correlative rights, providing for effective development and use, and promoting conservation of oil and gas—must be satisfied.<sup>120</sup> Prior to this amendment, any one of the interests would have been sufficient for the Chief to approve an application and issue a mandatory pooling order. Thus, this change gives less discretion to the Chief and ensures that mandatory pooling orders are only issued on certain limited occasions when all of the objectives of the law have been met.

Furthermore, the 2010 amendments limited the liability of the nonparticipating owners and restricted the area upon which drilling could commence. A landowner subject to a mandatory pooling order and designated as a nonparticipating owner “is not liable for actions or conditions associated with the drilling or operation of the well.”<sup>121</sup> In addition, “[n]o surface operations or disturbances to the surface of the land shall occur on a tract pooled by a[] [mandatory pooling] order” unless a landowner subject to the mandatory pooling order consents.<sup>122</sup> These two changes make the mandatory process more equitable to the landowners who do not wish to participate in the drilling and production of oil and gas on their tracts of land.

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<sup>118</sup> *Id.*

<sup>119</sup> An “owner” is “the person who has the right to drill on a tract or drilling unit, to drill into and produce from a pool.” *Id.* § 1509.01(K) (West Supp. 2013).

<sup>120</sup> *Id.* § 1509.27 (West Supp. 2013).

<sup>121</sup> *Id.*

<sup>122</sup> *Id.* Note, however, the amendment only refers to surface operations or disturbances. Thus, subsurface operations, as required in the horizontal drilling process, are allowed.

Although the General Assembly has recognized the need to update these laws to meet the demands and challenges posed by the hydraulic fracturing industry, the recent amendments to the law are not substantial enough to make the mandatory pooling orders equitable for landowners while still maintaining the purposes for the law. The General Assembly, however, is trending in the proper direction by making the laws more equitable through amendments. The amendments ensure that mandatory pooling orders are used as a last resort by limiting the discretion of the Chief to issue the mandatory pooling order and incentivizing parties to form voluntary pooling agreements. Also, the amendments prevent liability from attaching to nonparticipant owners. However, these changes do not address one of the most critical aspects of the law—the risk-penalty provision. Landowners subject to the order only have the choice between the following: (1) relent and become a participant in the drilling unit or (2) become a nonparticipating owner and pay a penalty of up to 200% of the reasonable costs and expenses of production.

### *3. Rationale and Criticisms of Ohio Revised Code § 1509.27*

Laws that provide mandatory pooling orders, while controversial, have utility and are necessary in states with an active oil and gas industry. The rationale behind mandatory pooling orders is the same as the purpose of oil and gas conservation laws. Mandatory pooling orders aim to protect the correlative rights and provide effective and efficient use of natural resources. The language of Ohio Revised Code § 1509.27 reflects those purposes, as they are mandatory conditions that must be satisfied to justify the issuance of a mandatory pooling order.

In addition, mandatory pooling orders serve as anti-holdout laws. The law is designed to protect a landowner who wishes to realize the mineral interests and exercise the landowner's right to drill, but cannot do so because the land is of an insufficient size and shape to meet the minimum acreage requirements. As a result, the landowner must pool adjoining tracts of land. Without mandatory pooling laws, one landowner could impede a plan for oil and gas production. Thus, in a state like Ohio, where many count on the oil and gas industry for economic gains, mandatory pooling laws are necessary to the oil and gas industry and to the landowners who wish to realize their mineral interests.

Despite the utility of the mandatory pooling laws, mandatory pooling orders are controversial. Two of the main criticisms of the mandatory pooling laws question whether the laws are constitutional or equitable. Many describe mandatory pooling orders as eminent-domain-type laws because the orders force landowners to participate in the production of



their mineral interests.<sup>123</sup> Although this criticism is controversial, courts consistently hold that mandatory pooling orders are constitutional.<sup>124</sup> Also, many question the equity of the risk-penalty aspect of Ohio's mandatory pooling law because of the possibility of paying a penalty of up to 200% of the reasonable costs and expenses of production.<sup>125</sup> Rather than repealing Ohio Revised Code § 1509.27,<sup>126</sup> Ohio should adopt a new mandatory pooling scheme to address the equity criticism of the mandatory pooling law.

### III. CONSTITUTIONAL ANALYSIS OF OHIO'S MANDATORY POOLING LAW

Landowners have long challenged the constitutionality of mandatory pooling laws.<sup>127</sup> In fact, given the increased attention to mandatory pooling laws due to the Marcellus Shale development, the media, landowners, and politicians have referred to mandatory pooling laws as eminent-domain-type laws.<sup>128</sup> Given the likelihood of the increased use of mandatory pooling in Ohio, future litigation may arise that questions the constitutionality of Ohio's mandatory pooling law. Therefore, this Part will analyze whether states have the power to issue a mandatory pooling order and whether the order amounts to an unlawful taking of private property.

The issue of whether a state has the authority to order a nonconsenting landowner to participate in a drilling unit has been a frequently litigated issue in many states. However, throughout the country courts have consistently upheld mandatory pooling laws as a valid use of the state's police power.<sup>129</sup> The use of the police power to issue mandatory pooling orders is justified because it is necessary "to protecting the correlative

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<sup>123</sup> Hunt, *supra* note 3, at A1; *see also* Carr Smyth, *supra* note 3, at 9A.

<sup>124</sup> *See infra* Part III.

<sup>125</sup> OHIO REV. CODE ANN. § 1509.27 (West Supp. 2013).

<sup>126</sup> *See* S.B. 318, 129th Gen. Assemb., Reg. Sess. (Ohio 2012), [http://www.legislature.state.oh.us/BillText129/129\\_SB\\_318\\_I\\_Y.pdf](http://www.legislature.state.oh.us/BillText129/129_SB_318_I_Y.pdf).

<sup>127</sup> *See, e.g.*, *Ohio Oil Co. v. Indiana*, 177 U.S. 190, 212 (1900); *Superior Oil Co. v. Foote*, 59 So. 2d 85, 93 (Miss. 1952); *Burtner-Morgan-Stephens Co. v. Wilson*, 586 N.E.2d 1062, 1064–65 (Ohio 1992); *Patterson v. Stanolind Oil & Gas Co.*, 77 P.2d 83, 89 (Okla. 1938).

<sup>128</sup> Carr Smyth, *supra* note 3, at 9A; Hunt, *supra* note 3, at A1.

<sup>129</sup> *See, e.g.*, *Ohio Oil Co.*, 177 U.S. at 212; *Superior Oil Co.*, 59 So. 2d at 93; *Burtner-Morgan-Stephens Co.*, 586 N.E.2d at 1064–65; *Patterson*, 77 P.2d at 89.

rights of owners in a common source of oil and gas supply.”<sup>130</sup> The Supreme Court of Ohio has held “the state’s police powers permit the General Assembly to enact legislation governing pooling arrangements, spacing, unitization[,] and other oil and gas drilling regulations.”<sup>131</sup> Based on Ohio case law<sup>132</sup> and case law from other jurisdictions,<sup>133</sup> it would be a stark departure from precedent for a court to rule that a state does not have the police power to issue a mandatory pooling order. Also, the specific language of Ohio Revised Code § 1509.27 states that pooling orders are only to be granted “to protect correlative rights” of landowners.<sup>134</sup> Therefore, a challenge questioning Ohio’s use of the police power to issue mandatory pooling orders will not likely be successful.

In addition to challenging the validity of the state’s use of its police power to issue a mandatory pooling order, a landowner might argue that the order amounts to a taking of the owner’s land.<sup>135</sup> A regulatory taking can occur when a government action causes an owner to suffer a permanent invasion of property.<sup>136</sup> However, the language of Ohio Revised Code § 1509.27 forbids such physical invasions of the land subject to a pooling order without the consent from the landowner.<sup>137</sup> A regulatory taking also can occur if a government regulation deprives the landowner of “all economically beneficial uses” of the property<sup>138</sup> or if the deprivation is less than 100% and satisfies the factors established in *Penn Central Transportation Co. v. New York City*.<sup>139</sup>

Although Ohio recognizes the mineral estate as a separate estate,<sup>140</sup> Ohio generally considers the parcel of land as a whole when determining if a taking has occurred.<sup>141</sup> If a landowner subject to a pooling order owns

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<sup>130</sup> *Patterson*, 77 P.2d at 89.

<sup>131</sup> *Burtner-Morgan-Stephens Co.*, 586 N.E.2d at 1064–65.

<sup>132</sup> *Id.*

<sup>133</sup> See, e.g., *Ohio Oil Co.*, 177 U.S. at 190; *Superior Oil Co.*, 59 So. 2d at 93; *Patterson*, 77 P.2d at 89.

<sup>134</sup> OHIO REV. CODE ANN. § 1509.27 (West Supp. 2013).

<sup>135</sup> Private property shall not be taken for public use without just compensation. U.S. CONST. amend. V; OHIO CONST. art. I, § 19.

<sup>136</sup> See *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 435 (1982).

<sup>137</sup> OHIO REV. CODE ANN. § 1509.27 (West Supp. 2013).

<sup>138</sup> *Lucas v. S.C. Coastal Council*, 505 U.S. 1003, 1019 (1992) (emphasis removed).

<sup>139</sup> 438 U.S. 104, 124 (1978).

<sup>140</sup> *Moore v. Indian Camp Coal Co.*, 80 N.E. 6, 7 (Ohio 1907).

<sup>141</sup> *State ex rel. Shelly Materials, Inc. v. Clark Cnty. Bd. of Comm’rs*, 875 N.E.2d 59, 67 (Ohio 2007).

both the surface and subsurface estates, the mandatory pooling order will not amount to a regulatory taking because the owner has not lost all economically beneficial uses of the property when considering the parcel as a whole. The owner has not lost all economically beneficial uses because the surface remained undisturbed. However, Ohio does consider the mineral estate “the relevant parcel for a compensable regulatory taking if the mineral estate was purchased separately from the other interests in the real property.”<sup>142</sup> Thus, under the proper facts, a landowner might be able to advance an argument of a taking if the owner acquired the mineral estate as a separate interest in the land by a deed, grant, lease, reservation, or exception. Ultimately, however, the mandatory pooling order provides a means for a landowner to be justly compensated for being forced to participate in the drilling unit.<sup>143</sup>

Furthermore, because of the notification and hearing requirements specified in Ohio Revised Code § 1509.27, it is not likely that a court would find the statute unconstitutional for not affording due process rights to the landowners subject to the pooling order. Due to these conclusions—that the issuance of a mandatory pooling order validly exercises the state’s police power, likely will not be considered a taking of private property, and properly affords due process from the approval process—Ohio Revised Code § 1509.27 is constitutional and will likely be upheld if challenged in court.

#### IV. OVERVIEW OF MANDATORY POOLING SCHEMES

The majority of state legislatures have adopted mandatory pooling laws<sup>144</sup> because courts consistently uphold them as constitutional under a

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<sup>142</sup> *Id.*

<sup>143</sup> OHIO REV. CODE ANN. § 1509.27 (West Supp. 2013).

<sup>144</sup> See ALA. CODE § 9-17-13(c) (LexisNexis 2001); ALASKA STAT. § 31.05.100 (2010); ARIZ. REV. STAT. ANN. § 27-505 (2000); COLO. REV. STAT. § 34-60-116 (7)(a)–(b) (2011); IND. CODE ANN. § 14-37-9-2 (2011); LA. REV. STAT. ANN. § 30:10 (A)(2)(b)(i) (Supp. 2012); MISS. CODE ANN. § 53-3-7 (West 2003); MO. REV. STAT. § 259.110 (2001); MONT. CODE ANN. § 82-11-202(b) (2011); NEB. REV. STAT. § 57-909(2) (2012); NEV. REV. STAT. ANN. § 522.060(4) (LexisNexis 2006); N.M. STAT. ANN. § 70-2-17(C) (2003); N.Y. ENVTL. CONSERV. LAW § 23-0901(3)(c)(1)(i) (McKinney 2012); OHIO REV. CODE ANN. § 1509.27 (West Supp. 2013); OKLA. STAT. ANN. tit. 52, § 87.1(e) (2011); 58 PA. STAT. ANN. § 408(c) (West 1996); TEX. NAT. RES. CODE ANN. § 102.052(a) (West 2011); UTAH CODE ANN. § 40-6-6.5(4)(d) (LexisNexis 2010); VA. CODE ANN. § 45.1-361.21(c)(7) (Supp. 2011); W. VA. CODE § 22C-9-7 (LexisNexis 2010); WYO. STAT. ANN. § 30-5-109(g) (2011).

state's police power.<sup>145</sup> Every major oil-producing state, with the exception of California and Kansas, has adopted some type of a mandatory pooling scheme.<sup>146</sup> While the existence of mandatory pooling laws is common among the states, each state has taken different approaches in addressing the issue of a nonconsenting owner who is subject to a mandatory pooling order.

Generally, the different types of mandatory pooling schemes can be grouped into three categories. The first category is known as the free-ride approach, which allows the well operator to carry the nonconsenting owner through the production process and leaves the owner liable only for the owner's portion of the costs of production if the well operation was successful.<sup>147</sup> The second category is known as the risk-penalty approach, which is Ohio's current approach to mandatory pooling.<sup>148</sup> Under the risk-penalty approach, a nonconsenting owner is subject to a penalty that is given to the well operator for taking the risk of drilling the well if the well is successful.<sup>149</sup> The third category is known as the enumerated options approach, which allows the nonconsenting owner to choose from a list of options upon receiving a mandatory pooling order.<sup>150</sup>

Ohio should consider these options to ensure that the mandatory pooling scheme is equitable for both the oil and gas industry and landowners subject to mandatory pooling orders. In particular, Ohio should consider the approach to mandatory pooling used by the other states in the Marcellus and Utica Shale region.<sup>151</sup> Therefore, this Part will

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<sup>145</sup> See *supra* Part III.

<sup>146</sup> Brigid R. Landy & Michael B. Reese, *Getting to "Yes": A Proposal for a Statutory Approach to Compulsory Pooling in Pennsylvania*, 41 ENVTL. L. REP.: NEWS & ANALYSIS 11044, 11051 (2011).

<sup>147</sup> See *infra* Part IV.A.

<sup>148</sup> See *supra* Part II.C.1.

<sup>149</sup> See *infra* Part IV.B.

<sup>150</sup> See *infra* Part IV.C.

<sup>151</sup> Hobart King, *Marcellus Shale—Appalachian Basin Natural Gas Play*, GEOLOGY.COM, <http://geology.com/articles/marcellus-shale.shtml> (last visited Mar. 4, 2014) (noting that the Marcellus and Utica Shale region spreads over six states: Maryland, New York, Pennsylvania, Ohio, Virginia, and West Virginia); see also Hobart King, *Utica Shale—The Natural Gas Giant Below the Marcellus*, GEOLOGY.COM, <http://geology.com/articles/utica-shale/> (last visited Mar. 4, 2014) (pointing out that the Marcellus Shale region is in only small portions of Maryland and Virginia compared to New York, Pennsylvania, Ohio, and West Virginia).

provide an analysis of the three approaches to address the effect of mandatory pooling on the nonconsenting owner.

*A. Free-Ride Mandatory Pooling Scheme*

One approach to address the issue of a nonconsenting owner subject to a mandatory pooling order is the free-ride approach. The free-ride approach allows the nonconsenting owner to be “‘carried’ as to [the owner’s] proportionate share of expenses without penalty during the time that the well is being drilled.”<sup>152</sup> Thus, the nonconsenting owner has a free ride through the production process.

The nonconsenting owner will be liable only for the owner’s share of the cost of production.<sup>153</sup> If the operation is not successful, then the nonparticipating owner is not liable for any of the costs of production.<sup>154</sup> The effect of this approach is that the well operator takes all of the risks associated with production, while the nonconsenting owner bears no risks and contributes only to the costs of production if the operation is successful. The free-ride approach has been described as the operator giving the nonconsenter an “interest-free loan”—if the operation is unsuccessful, the loan will be defaulted without compensation to the operator.<sup>155</sup> The free-ride mandatory pooling scheme is the most favorable scheme for landowners subject to a mandatory pooling order because this is a win-win situation for the nonconsenting owner.

The landowner-favored effect of the free-ride approach makes it heavily criticized for offending the purposes of mandatory pooling laws. One criticism of the free-ride approach is that it fails to promote voluntary pooling agreements.<sup>156</sup> The free-ride approach “encourage[s] nonconsenting interest owners to hold out of voluntary pooling agreements and to await the forced pooling order that will leave them without a share of the risk in the event of a dry hole or failed drilling operation.”<sup>157</sup> Another criticism of the free-ride approach is that it discourages oil production: “[P]otential operator[s] will be discouraged from drilling if

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<sup>152</sup> Bruce M. Kramer, *Compulsory Pooling and Unitization: State Options in Dealing with Uncooperative Owners*, 7 J. ENERGY L. & POL’Y 255, 261 (1986).

<sup>153</sup> *Id.*

<sup>154</sup> *Id.* at 262.

<sup>155</sup> *Id.*

<sup>156</sup> Kevin L. Colosimo & Daniel P. Craig, *Compulsory Pooling and Unitization in the Marcellus Shale: Pennsylvania’s Challenges and Opportunities*, 83 PA. B. ASS’N Q. 47, 56 (2012); Kramer, *supra* note 152, at 263; Landy & Reese, *supra* note 146, at 11053.

<sup>157</sup> Landy & Reese, *supra* note 146, at 11053.

[they] know[] that [they have] to carry the full risk of a dry hole . . . .”<sup>158</sup>  
As a result, the free-ride approach has “largely fallen out of favor” with major oil producing states.<sup>159</sup>

### *B. Risk-Penalty Mandatory Pooling Scheme*

Perhaps the most common approach to mandatory pooling is the risk-penalty approach.<sup>160</sup> The risk-penalty approach addresses one of the main criticisms of the free-ride approach in that it seeks to compensate the well operator for taking the risk of drilling. The approach is similar to the free-ride approach because the well operator carries the nonconsenting landowner through the drilling process,<sup>161</sup> and the nonconsenting owner does not have to pay the well operator if the well is unsuccessful.<sup>162</sup> Thus, the well operator bears the risks of drilling a dry well and not being compensated for the costs of drilling. If the well operation is successful, the nonconsenting owner must reimburse the well operator for the reasonable costs of production. In addition to reimbursing the well operator, the nonconsenting owner must also pay a penalty that is assessed against those costs to reward the well operator for taking the risks of drilling a dry well.<sup>163</sup> The risk-penalty approach “seek[s] to achieve the

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<sup>158</sup> Kramer, *supra* note 152, at 264.

<sup>159</sup> Colosimo & Craig, *supra* note 156, at 56. Four states use the free-ride approach. See ALASKA STAT. § 31.05.100(c) (2010); ARIZ. REV. STAT. ANN. § 27-505(A) (2000); IND. CODE ANN. § 14-37-9-2 (West 2011); MO. ANN. STAT. § 259.110(1) (West 2001). An example of a provision of a mandatory pooling law that indicates a free-ride approach is: Those “who refuse to agree upon pooling, the order shall provide for reimbursement for costs chargeable to each [nonparticipating owner] out of, and only out of, production from the unit belonging to such” nonparticipating owner. ALASKA STAT. § 31.05.100(c); ARIZ. REV. STAT. ANN. § 27-505(A).

<sup>160</sup> See ALA. CODE § 9-17-13(c) (LexisNexis 2001); COLO. REV. STAT. § 34-60-116(7)(b) (2011); LA. REV. STAT. ANN. § 30:10(A)(2)(b)(i) (Supp. 2012); MISS. CODE ANN. § 53-3-7(2)(g) (2003); MONT. CODE ANN. § 82-11-202(2) (2011); NEB. REV. STAT. § 57-909(2) (2012); NEV. REV. STAT. ANN. § 522.060(4) (LexisNexis 2006); N.M. STAT. ANN. § 70-2-17(C) (2003); OHIO REV. CODE § 1509.27(F) (West Supp. 2013); TEX. NAT. RES. CODE ANN. § 102.052(a) (West 2011); UTAH CODE ANN. § 40-6-6.5(4)(d) (LexisNexis 2010); WYO. STAT. ANN. § 30-5-109(g) (2011).

<sup>161</sup> Kramer, *supra* note 152, at 261.

<sup>162</sup> *Id.*

<sup>163</sup> *Id.* See also N.Y. ENVTL. CONSERV. LAW § 23-0901(3)(a)(4) (McKinney 2012) (“‘Risk penalty’ means the percentage applied to well costs to reimburse the well operator for the risk involved with the exploration for and development of a well . . . .”).

objective of compensating the risk-taker and preventing the free ride by the non-consenting owner.”<sup>164</sup>

Although the risk-penalty approach is the most common approach to mandatory pooling, state legislatures have adopted many variations of this approach. The common thread among the varied approaches, however, is that all of the statutes impose a percentage of the nonconsenter’s portion of reasonable costs and expenses as a penalty to reward the well operator.<sup>165</sup> The risk-penalty schemes vary by setting the specified percentage to properly reflect the risk involved in the well operation and determining what expenses the penalty may be assessed against.<sup>166</sup>

Because the purpose of the risk-penalty approach is to reward the well operator for bearing the risks associated with drilling,<sup>167</sup> the penalty assessed to the nonconsenter should reflect the risk involved in drilling. In general, there are three risks associated in drilling: “drilling a dry hole[,] . . . encountering unexpected mechanical or geological problems which greatly increase the actual cost of drilling[,] . . . [and] drilling a marginally productive well which will never return to the operator his investment in the drilling and operating expenses.”<sup>168</sup> The various risk-penalty approaches differ on how accurately the mandatory pooling laws actually reflect the amount of risk involved. In some states, the mandatory pooling statute calls for a fixed percentage,<sup>169</sup> while other states allow for a

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<sup>164</sup> Kramer, *supra* note 152, at 264. See also *In re Kohlman*, 263 N.W.2d 674, 675 (S.D. 1978) (“[Risk penalty] is intended to relieve the nondrilling interest owner from having to advance his proportionate share of the drilling costs but provide extra compensation from production (if oil is found) to the drilling party who has advanced the entire drilling costs and who would absorb the entire cost of a ‘dry hole.’”).

<sup>165</sup> See ALA. CODE § 9-17-13(c) (LexisNexis 2001); COLO. REV. STAT. § 34-60-116(7)(b) (2011); LA. REV. STAT. ANN. § 30:10(A)(2)(b)(i) (Supp. 2012); MISS. CODE ANN. § 53-3-7(2)(g) (2003); MONT. CODE ANN. § 82-11-202(2) (2011); NEB. REV. STAT. § 57-909(2) (2012); NEV. REV. STAT. ANN. § 522.060(4) (LexisNexis 2006); N.M. STAT. ANN. § 70-2-17(C) (2003); OHIO REV. CODE § 1509.27(F) (West Supp. 2013); TEX. NAT. RES. CODE ANN. § 102.052(a) (West 2011); UTAH CODE ANN. § 40-6-6.5(4)(d) (LexisNexis 2010); WYO. STAT. ANN. § 30-5-109(g) (2011).

<sup>166</sup> See Kramer, *supra* note 152, at 264–65.

<sup>167</sup> *Kohlman*, 263 N.W.2d at 675.

<sup>168</sup> Kramer, *supra* note 152, at 266.

<sup>169</sup> See ALA. CODE § 9-17-13(c) (LexisNexis 2011) (providing a fixed 150% penalty); COLO. REV. STAT. § 34-60-116(7)(b) (2011) (providing a fixed percentage based on the specific type of cost involved); LA. REV. STAT. ANN. § 30:10(A)(2)(b)(i) (Supp. 2012) (providing a 200% set penalty); MISS. CODE ANN. § 53-3-7(2)(g) (2003) (providing a fixed percentage based on the specific type of cost involved); MONT. CODE ANN.

(continued)

more flexible approach by setting a ceiling on the specified percentage to be applied.<sup>170</sup>

The statutes that allow for flexible percentages are better suited in carrying out the purposes of the risk-penalty approach. For example, if a proposed drilling site has an estimated success rate of 90%, the relative likely risk involved is minimal. Under a flexible process for setting the specified percentage, the administrative body will be able to reflect the relative minimal risk when setting the percentage.<sup>171</sup> On the other hand, under a fixed system the percentage is set by law regardless of the relative likelihood of the success of the drilling operations.

In addition to the states differing on the specified percentage to apply, states also differ on what is considered a reasonable expense to assess the percentage against. Several states' statutes identify an extensive list of costs that the risk penalty may be assessed against.<sup>172</sup> Alternatively, other risk-penalty systems first require the parties to agree to the reasonable costs associated with drilling and, then, give the administrative body the authority to allocate the costs in the event that the parties dispute the costs.<sup>173</sup> In general, however, most statutes consider costs such as drilling,

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§ 82-11-202(2)(b) (2011) (providing a fixed percentage based on the specific type of cost involved); NEB. REV. STAT. § 57-909(2) (2012) (providing a fixed percentage based on the depth of the well); NEV. REV. STAT. ANN. § 522.060(2) (LexisNexis 2006) (providing a 300% set penalty); UTAH CODE ANN. § 40-6-6.5(4)(d) (LexisNexis 2010) (providing a fixed percentage based on the specific type of cost involved).

<sup>170</sup> See N.M. STAT. ANN. § 70-2-17(C) (2003) (providing that a risk penalty may not exceed 200%); OHIO REV. CODE ANN. § 1509.27(F) (West Supp. 2013) (“The total amount receivable . . . shall in no event exceed [200%]. . . .”); TEX. NAT. RES. CODE ANN. § 102.052(a) (West 2011) (providing that a risk penalty may not exceed 100%); WYO. STAT. ANN. § 30-5-109(g)(ii) (2011) (providing that penalty can be “[u]p to” 300% and “up to” 200% depending on the specific cost involved).

<sup>171</sup> See Colosimo & Craig, *supra* note 156, at 57.

<sup>172</sup> See ALA. CODE § 9-17-13(c) (LexisNexis 2001); COLO. REV. STAT. § 34-60-116(7)(b) (2011); LA. REV. STAT. ANN. § 30:10(A)(2)(b)(ii) (Supp. 2012); MISS. CODE ANN. § 53-3-7(2)(g) (2003); MONT. CODE ANN. § 82-11-202(b) (2011); NEB. REV. STAT. § 57-909(2) (2012); N.Y. ENVTL. CONSERV. LAW § 23-0901(3)(c)(1)(ii)(I) (McKinney 2012); UTAH CODE ANN. § 40-6-6.5(4)(a)(I) (LexisNexis 2010); WYO. STAT. ANN. § 30-5-109(g) (2011).

<sup>173</sup> See NEV. REV. STAT. ANN. § 522.060(4) (LexisNexis 2006); N.M. STAT. ANN. § 70-2-17(C) (2003); OHIO REV. CODE ANN. § 1509.27(F) (West Supp. 2013); TEX. NAT. RES. CODE ANN. § 102.052(b) (West 2011).



testing, completing, equipping, and operating the well, along with supervision expenses, for allocating the reasonable costs of production.<sup>174</sup>

The primary effect of imposing a risk penalty is to encourage voluntary agreements among the parties. With a “risk penalty hanging over their heads, holdouts are more likely to cut a voluntary deal with the operator and other interest holders.”<sup>175</sup> Thus, the prospect of facing a risk penalty—which in some cases may be fixed at 300%<sup>176</sup> of the reasonable costs of production—serves as a deterrent for those who do not wish to make a voluntary agreement. Furthermore, voluntary agreements made in the marketplace often have more favorable terms than those mandated by a mandatory pooling order.<sup>177</sup>

The main criticism of the risk-penalty approach is that it is too much of a deterrent for landowners and is favorable for the well operators. Despite the objective of the risk-penalty approach, which is to reward the well operator for taking the risk of drilling,<sup>178</sup> many of the risk-penalty provisions are fixed and do not allow the administrative body to accurately assess the actual risks involved with the drilling operations. In some states, the amount of the penalty can substantially reduce the amount that a nonconsenting owner receives for the pro rata share of the oil and gas extracted from the owner’s tract of land. Moreover, parties who are unable, despite reasonable efforts, to form a voluntary agreement must either contribute to the costs of production up front or be carried through the production process and pay a substantial penalty for refraining from participating in drilling operations.<sup>179</sup> While the free-ride approach is most favorable for the nonconsenting landowner subject to a mandatory pooling order, the risk-penalty approach is most favorable to the well operators.

### C. Enumerated Options Mandatory Pooling Scheme

The third approach to mandatory pooling, the enumerated options approach, is the most common approach among the states within the

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<sup>174</sup> See, e.g., LA. REV. STAT. ANN. § 30:10(A)(2)(b)(ii) (Supp. 2012).

<sup>175</sup> Landy & Reese, *supra* note 146, at 11053. See also Colosimo & Craig, *supra* note 156, at 57 (“The risk-penalty acts as an incentive for a working interest owner[] to enter into a voluntary agreement with the proposed well operator rather than waiting for the government to intervene . . .”).

<sup>176</sup> NEV. REV. STAT. ANN. § 522.060(4) (LexisNexis 2006) (providing a 300% set penalty).

<sup>177</sup> Kramer, *supra* note 152, at 264–65.

<sup>178</sup> *Id.*

<sup>179</sup> See, e.g., OHIO REV. CODE ANN. § 1509.27(F) (West Supp. 2013).

Marcellus Shale region.<sup>180</sup> The enumerated options mandatory pooling scheme allows an owner subject to a pooling order to make an election from a list of options enumerated in the state's mandatory pooling statute before the owner's interests can be pooled.<sup>181</sup> Unlike the risk-penalty approach, nonconsenting owners will have several alternatives to choose from under the enumerated options approach instead of being forced to pay a risk penalty.

The specific options offered to a nonconsenting owner vary from state to state. One option often available is the option to participate in the drilling unit by contributing the nonconsenting owner's share of the costs of production prior to the commencement of drilling.<sup>182</sup> If a nonconsenter elects this option, the nonconsenter essentially becomes a working interest owner. This option is often available throughout the pooling process in most mandatory pooling schemes, including the strict risk-penalty states.<sup>183</sup> Therefore, while this is an option for nonconsenting owners, the option itself is not unique to the enumerated options approach.

Another common option is for the nonconsenter to surrender or assign the nonconsenter's interest to participants in the pooled unit and accept a bonus and royalty payment in return.<sup>184</sup> Under this option, the landowner will not be responsible for the costs of production.<sup>185</sup> Rather, the nonconsenter's working interest is effectively surrendered or assigned on either a temporary or permanent basis. The tradeoff for not contributing to the costs of production under this option is that the nonconsenter's potential gain from the pro rata portion of the oil and gas extracted from the nonconsenter's tract of land may be considerably less than what it

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<sup>180</sup> See N.Y. ENVTL. CONSERV. LAW § 23-0901(3)(c)(1)(i) (McKinney 2012); 58 PA. STAT. ANN. § 408(c) (West 1996); VA. CODE ANN. § 45.1-361.21(c)(7) (Supp. 2011); W. VA. CODE ANN. § 22C-9-7 (LexisNexis 2010). The current mandatory pooling laws in effect in Pennsylvania and West Virginia are not applicable to the depth of the minerals in the Marcellus Shale. See Colosimo & Craig, *supra* note 156, at 54. However, advocates in both states are currently attempting to reform those laws so that they are applicable to the Marcellus Shale region. See *id.* at 49; Landy & Reese, *supra* note 146, at 11050.

<sup>181</sup> Kramer, *supra* note 152, at 272.

<sup>182</sup> See, e.g., N.Y. ENVTL. CONSERV. LAW § 23-0901(3)(c)(1)(i) (McKinney 2012); OKLA. STAT. ANN. tit. 52, § 87.1(e) (West 2011); 58 PA. STAT. ANN. § 408(c) (West 1996); VA. CODE ANN. § 45.1-361.21(c)(7) (Supp. 2011); W. VA. CODE ANN. § 22C-9-7 (LexisNexis 2010).

<sup>183</sup> See OHIO REV. CODE ANN. § 1509.27(F) (Supp. 2013).

<sup>184</sup> See, e.g., OKLA. STAT. ANN. tit. 52, § 87.1(e) (West 2011).

<sup>185</sup> See 58 PA. STAT. ANN. § 408(c) (West 1996).

would be as a working interest owner. The amount of compensation—in terms of a per acreage bonus and royalty payment—can either be established by the parties themselves or by the administrative body controlling the pooling procedure.<sup>186</sup>

A similar option is the option to be integrated in the drilling unit as a royalty interest owner.<sup>187</sup> A royalty interest holder is not responsible for the costs of production or the risks involved in drilling.<sup>188</sup> As a royalty interest holder, the nonconsenter will receive royalty payments from the nonconsenter's pro rata share of production.<sup>189</sup> This royalty payment will likely have a statutory minimum, but may be based on the prevailing royalty interest payment in the pooled unit or surrounding units.<sup>190</sup> In New York, for example, the royalty interest is “equal to the lowest royalty in an existing lease . . . , but no less than one-eighth.”<sup>191</sup>

The final common enumerated option is for the well operator to carry the nonconsenting owner's proportion of the costs of production during the drilling process.<sup>192</sup> This option is essentially the risk-penalty approach. After the well begins to produce, the well operator is entitled to a portion of the nonconsenter's pro rata share of production until the well operator recoups the reasonable costs of production, as well as a penalty assessed to those costs.<sup>193</sup> Similar to pure risk-penalty states, the amount of the penalty and what expenses the penalty may be assessed against vary from state to state.<sup>194</sup>

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<sup>186</sup> *See id.*

<sup>187</sup> *See, e.g.,* N.Y. ENVTL. CONSERV. LAW § 23-0901(3)(c)(1)(i) (McKinney 2012); OKLA. STAT. ANN. tit. 52, § 87.1(e) (West 2011); VA. CODE ANN. § 45.1-361.21(g) (Supp. 2011).

<sup>188</sup> N.Y. ENVTL. CONSERV. LAW ANN. § 23-0901(3)(a)(3).

<sup>189</sup> *Id.*; OKLA. STAT. ANN. tit. 52, § 87.1(e) (West 2011); VA. CODE ANN. § 45.1-361.1 (Supp. 2011).

<sup>190</sup> N.Y. ENVTL. CONSERV. LAW ANN. § 23-0901(3)(a)(3); OKLA. STAT. ANN. tit. 52, § 87.1(e).

<sup>191</sup> N.Y. ENVTL. CONSERV. LAW ANN. § 23-0901(3)(a)(3).

<sup>192</sup> *See, e.g., id.* § 23-0901(3)(a)(4); OKLA. STAT. ANN. tit. 52, § 87.1(e); 58 PA. STAT. ANN. § 408(c) (West 1996); VA. CODE ANN. § 45.1-361.21(c)(7); W. VA. CODE ANN. § 22C-9-7(b)(6) (LexisNexis 2010).

<sup>193</sup> *See, e.g.,* N.Y. ENVTL. CONSERV. LAW ANN. § 23-0901(3)(c)(1)(ii)(A); OKLA. STAT. ANN. tit. 52, § 87.1(e); 58 PA. STAT. ANN. § 408(c); VA. CODE ANN. § 45.1-361.21 (c)(7); W. VA. CODE ANN. § 22C-9-7(b)(6).

<sup>194</sup> *See supra* Part IV.B.

In addition to allowing the nonconsenter to make an election, a key feature to the enumerated options approach is that each scheme has an automatic option that is triggered if the owner does not make a timely election.<sup>195</sup> The automatic option varies from state to state. In New York, for example, if the owner fails to make a timely election, the owner will become a royalty interest owner.<sup>196</sup> Thus, the landowner has a set period of time after the Chief issues a pooling order to select one of the enumerated options. The Chief will issue the order if a default occurs because the selection period lapses and the landowner fails to make an election.

Of the three types of mandatory pooling schemes, the enumerated options approach best replicates the marketplace. “States that authorize the use of alternatives provide a more realistic replica of the actual marketplace . . . and, therefore, more closely achieve what the market cannot do because of the rule of capture.”<sup>197</sup> The enumerated options approach “allows for flexibility and fact-specific determinations”<sup>198</sup> for the nonoperator to “balance his or her interests, opting for what each believes to be the best approach for his or her unique situation.”<sup>199</sup> In addition, having the risk penalty as one of the alternatives will still provide an incentive for the parties to form voluntary pooling agreements.<sup>200</sup>

Although some state that the enumerated options approach promotes voluntary agreements<sup>201</sup> more so than the strict risk-penalty approach, landowners may still choose a wait-and-see approach before forming a voluntary agreement in an enumerated options state. Landowners may decide to postpone making a voluntary agreement until after their tracts of land have been pooled by the mandatory pooling order because the alternatives in an enumerated options scheme mimic the marketplace.<sup>202</sup> Thus, by offering similar options to what may be agreed upon in the marketplace, an enumerated options approach may disincentivize landowners to voluntarily pool their tracts of land.

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<sup>195</sup> See, e.g., N.Y. ENVTL. CONSERV. LAW ANN. § 23-0901(3)(c)(1)(i); OKLA. STAT. ANN. tit. 52, § 87.1(e); VA. CODE ANN. § 45.1-361.21(E).

<sup>196</sup> N.Y. ENVTL. CONSERV. LAW ANN. § 23-0901(3)(c)(1)(i).

<sup>197</sup> Kramer, *supra* note 152, at 274.

<sup>198</sup> Landy & Reese, *supra* note 146, at 11056.

<sup>199</sup> *Id.* at 11058.

<sup>200</sup> Kramer, *supra* note 152, at 274; Landy & Reese, *supra* note 146, at 11056.

<sup>201</sup> Kramer, *supra* note 152, at 274; Landy & Reese, *supra* note 146, at 11056.

<sup>202</sup> See *supra* Part IV.C.

## V. PROPOSAL FOR A NEW MANDATORY POOLING SCHEME FOR OHIO

Ohio's current mandatory pooling law, which was enacted in 1965 to respond to the rule of capture and the migratory nature of oil,<sup>203</sup> is outdated. Today, Ohio faces new challenges from the emergence of the shale gas development, which involves nonmigratory shale natural gas. Rather than using traditional vertical wells to extract the migratory oil, the extraction technologies of hydraulic fracturing and horizontal drilling pose additional challenges on the mandatory pooling laws. Furthermore, hydraulic fracturing poses environmental concerns that contribute to landowners' decisions to refrain from the drilling process. Therefore, the Ohio General Assembly must update its current approach to mandatory pooling to respond to these new demands.

Instead of repealing or replacing the current law in its entirety, the Ohio General Assembly should use the current language of Ohio Revised Code § 1509.27 as a basis and make several amendments to make mandatory pooling more equitable for all involved in the process. Mandatory pooling is a vital part to a comprehensive regulatory scheme.<sup>204</sup> While some may advocate eliminating mandatory pooling in its entirety,<sup>205</sup> doing so would have significant negative effects to Ohio landowners, the oil and gas industry, and state and local governments.<sup>206</sup> Moreover, many of the current provisions in Ohio Revised Code § 1509.27 are provisions that must be part of the new solution to meet the demands posed by shale gas development.<sup>207</sup>

The first step in making mandatory pooling more equitable for those involved in the process is to move from a strict risk-penalty approach to an enumerated options approach. The current risk-penalty approach does not provide landowners subject to a pooling order with any option other than to

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<sup>203</sup> See *supra* Part II.B.

<sup>204</sup> Kramer, *supra* note 152, at 288.

<sup>205</sup> See sources cited *supra* note 114.

<sup>206</sup> Approximately \$4 billion has been invested in eastern Ohio for shale gas development. Joe Vardon, *Ohio Economy Is Taking Off*, COLUMBUS DISPATCH, Feb. 17, 2013, at A1. This investment led to an estimated 6,000 jobs from early 2011 to 2012. *Id.* Also, by 2014, further investment could create 65,680 total fracking-related jobs in Ohio. Vanac, *supra* note 2, at D1.

<sup>207</sup> These provisions include utilizing the risk-penalty system as one of the options in an enumerated options scheme, preventing surface operations on tracts of land pooled by a mandatory pooling order, protecting landowners pooled by a mandatory pooling order from liability for drilling operations, and continuing the process and requirements necessary to issue a mandatory pooling order. See OHIO REV. CODE ANN. § 1509.27 (West Supp. 2013).

pay a penalty of up to 200% of the reasonable costs of production or become a working interest owner. The lack of alternatives fails to recognize the strong opposition to hydraulic fracturing.

When Ohio's mandatory pooling law was enacted in the 1960s, economic reasons, rather than environmental reasons, motivated landowners' decisions to hold out from drilling operations. Landowners in the 1960s may have decided to hold out based on the assumption that a more lucrative agreement could be reached in the future. Today, however, many landowners are concerned about the potential environmental ramifications included in the risks of hydraulic fracturing.<sup>208</sup> Those holding out for environmental reasons are not holding out with the assumption of a more lucrative offer in the future, but on the assumption of not wishing to realize their mineral rights. As a result, these landowners will likely take a wait-and-see approach on the outcome of the mandatory pooling process before voluntarily leasing their mineral rights. Under the strict risk-penalty approach, these landowners could be severely punished by the risk penalty. However, under an enumerated options approach, these landowners would have a second chance to form a deal after the Chief issues a mandatory pooling order that is similar to what could be formed in the marketplace.

The enumerated options approach would allow the mandatory pooling order to mimic the marketplace.<sup>209</sup> Under this approach, landowners who opt to take a wait-and-see approach will be able to make an election from a list of options similar to those available as if a voluntary pooling agreement takes place. The options enumerated in the statute should provide alternatives that not only provide landowners with the opportunity to make a fact-specific determination based on their assessment of their own unique situations, but also options that encourage voluntary agreements. Therefore, the mandatory pooling order in Ohio should provide the nonconsenting landowner the option to participate in the drilling unit as a working interest owner, the option to assign the landowner's interests in return for a bonus and royalty payment, and the option for the well operator to carry the landowner through the drilling process subject to a risk penalty.

The option to participate in the drilling unit as a working interest owner will require the nonconsenting landowner to contribute the cost of production prior to the commencement of drilling. In return, the

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<sup>208</sup> See, e.g., Hunt, *supra* note 3, at A4.

<sup>209</sup> Kramer, *supra* note 152, at 274.

nonconsenting owner will be able to earn the entire working interests of the production. However, this option is limited to those who have the financial capabilities to contribute to the extensive costs of production up front.<sup>210</sup>

The second option—to surrender or assign the working interest in return for a per acreage bonus payment or royalty payment—is a more conservative option and may be appealing to landowners who do not have the financial capabilities to contribute to the costs of production. The bonus payment will compensate the nonconsenting owner for assigning the owner's working interest rights in the minerals. The royalty payment, however, will allow the nonconsenting owner to benefit from the potential profit in the production of shale gas from the owner's tract of land. The statute should allow the parties to negotiate the terms of the agreement for the acreage bonus and royalty payments. If, however, the parties cannot agree on the terms, the Division of Oil and Gas shall have the authority to set the amount of compensation based on the prevailing rates within the drilling unit or surrounding units.<sup>211</sup>

The third option for a nonconsenting owner would allow the well operator to carry the owner through the production process and the owner would have the costs of production taken out of the pro rata share of production in addition to a penalty. Ohio's current risk-penalty provision should be preserved and used for this option.<sup>212</sup> The current risk-penalty provision provides the Division of Oil and Gas the flexibility needed to reflect the amount of risk involved in the drilling operation. In addition, the maximum 200% penalty will serve as a deterrent and will encourage voluntary pooling.<sup>213</sup>

The mandatory pooling order also must designate one of the options as the automatic election. This option would only be triggered if a landowner fails to make a timely selection of one of the enumerated options. In order to encourage voluntary pooling agreements and participation in the mandatory pooling process, Ohio should make the risk-penalty option the automatic election if a timely election is not made. The option to become a working interest owner should not be the automatic provision because of

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<sup>210</sup> Landy & Reese, *supra* note 146, at 11056.

<sup>211</sup> See, e.g., N.Y. ENVTL. CONSERV. LAW ANN. § 23-0901(3)(a)(3) (West 2007) (“The . . . royalty owner shall receive a royalty equal to the lowest royalty in an existing lease in the [drilling] unit, but no less than one-eighth.”). Notably, an economic impact report estimated that the average compensation from entering a lease with an oil and gas company is \$2,500 per acre with a 15% royalty payment. Vanac, *supra* note 2, at D4.

<sup>212</sup> OHIO REV. CODE ANN. § 1509.27 (Supp. 2013).

<sup>213</sup> *Id.* (stating that the percentage shall not exceed 200%).

the extensive expenses landowners would have to contribute prior to drilling.<sup>214</sup> Also, the option to be integrated as a royalty interest owner may be an incentive for landowners to refrain from participating in the pooling process and in the negotiations of reasonable terms of compensation. Thus, the risk-penalty option may incentivize landowners to participate in the pooling process and to make a fact-specific determination based on their assessment of their own unique situations. The landowner may continue to negotiate with the well operator after the default risk-penalty option is triggered, but the landowner will lack substantial bargaining power and the options provided by the pooling order will no longer be available.

If Ohio adopts the enumerated options approach, the purpose of having mandatory pooling laws will still be realized. Mandatory pooling laws should protect the correlative rights of landowners, promote effective development, and promote conservation.<sup>215</sup> By not amending the current requirements that must be met before the Chief can issue a mandatory pooling order,<sup>216</sup> pooling orders in Ohio will still be issued to realize those purposes. One could argue that, due to the nonmigratory nature of shale gas and the ability to control hydraulic fractures and horizontal drilling, mandatory pooling laws are unnecessary. In regard to the controlled nature of the extraction technologies, horizontal well operators would still need to gain permission from all landowners over a pool to avoid subsurface trespass. Additionally, although shale gas is nonmigratory, slight seepage of shale gas is possible from the outer portions of a tract of land adjoining a drilling unit. Furthermore, not having the ability to pool tracts of land could permanently leave the shale gas stored beneath the surface of a single tract of land undeveloped. It would not be efficient or cost effective to realize the shale gas of the small tract of land in the future. The availability to mandatorily pool tracts of land will continue to protect the correlative rights of landowners and promote effective development of shale gas while promoting conservation, even when dealing with the physical properties of shale gas and the extraction technologies.

Due to the utility of mandatory pooling, the enumerated options approach will provide an equitable pooling scheme for all involved in the

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<sup>214</sup> Landy & Reese, *supra* note 146, at 11056.

<sup>215</sup> See *supra* Part II.B.

<sup>216</sup> OHIO REV. CODE ANN. § 1509.27 (“[T]he chief, if satisfied . . . that mandatory pooling is necessary to protect correlative rights or to provide effective development, use, or conservation of oil and gas, shall issue . . . a mandatory pooling order . . .”).



process. The ability of a landowner to make an election from a list of options best replicates the marketplace.<sup>217</sup> Further, the enumerated options approach recognizes that holdouts from the shale gas development may be motivated by noneconomic reasons. Thus, the enumerated options approach will allow the nonconsenting owner to have a second chance to form an equitable agreement.

Although the enumerated options approach is more equitable for landowners, it is also equitable for the oil and gas industry. The agreements made between the parties after a pooling order has been issued—with or without the assistance from the Division of Oil and Gas—are similar to those that would be made in the marketplace.<sup>218</sup> After the Chief issues an order for mandatory pooling, the well operator will likely have an increased bargaining position when negotiating with the nonconsenter because the nonconsenter must comply with the order or be subject to the risk penalty as a default election. Additionally, the enumerated option approach will not allow free-riding as an option. As a result, the enumerated options approach with an automatic risk-penalty option will be more equitable for all parties involved compared to Ohio's current strict risk-penalty scheme.

In light of the strong opposition to hydraulic fracturing from many landowners, one negative aspect of the enumerated options approach is that it may make the decision to initially hold out more attractive. Therefore, well operators will have to initiate the lengthy and expensive mandatory pooling process<sup>219</sup> and will also consume government resources. The automatic risk-penalty option will help alleviate this potential problem by deterring individuals from refraining from the process altogether. Overall, the enumerated options approach will encourage voluntary pooling agreements.<sup>220</sup>

## VI. CONCLUSION

Hydraulic fracturing, for better or worse, is here to stay in Ohio. Mandatory pooling is a necessary component of a robust oil and gas conservation scheme because it aims to promote efficient development of natural resources and protects the correlative rights of landowners. Due to the necessary and critical role mandatory pooling plays in the development

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<sup>217</sup> Kramer, *supra* note 152, at 274.

<sup>218</sup> *Id.*

<sup>219</sup> OHIO REV. CODE ANN. § 1509.27.

<sup>220</sup> See Landy & Reese, *supra* note 146, at 11056; see also Kramer, *supra* note 152, at 274.

of shale natural gas, Ohio must make sure this process is equitable to all stakeholders involved.

Ohio's mandatory pooling law is inadequate to meet the demands of the emerging hydraulic fracturing industry and is not equitable to landowners who do not wish participate in shale natural gas development. The modest changes made to the law in 2010 have not gone far enough to respond to these demands. By replacing Ohio's pure risk-penalty approach with an enumerated options approach, landowners subject to a mandatory pooling order will have additional alternatives. Adopting an enumerated options approach will continue to carry out the purposes of mandatory pooling and will encourage voluntary agreements. Therefore, the Ohio General Assembly must act now to amend this constitutional, but controversial law.