


Sample Spacing Unit

	 (well)	
		unleased acreage

The illustration above shows one spacing unit with nine parcels—eight leased to the well operator and one unleased. All nine are “assigned to the well.” Assume that the nine parcels are all the same size. The unleased owner holds 1/9 of the acreage in the unit. Therefore, if the unleased owner elects to be integrated as a participating or non-participating owner, then he or she will be liable for 1/9 of the costs and will be compensated for 1/9 of the production. The owner of the unleased acreage must make an election prior to the hearing, which will most likely be scheduled before the well is drilled.

To see an example of an approved spacing unit, go to:

http://www.dec.ny.gov/docs/materials_minerals_pdf/cutlercreekexb2.pdf

No Trespassing

DEC’s integration order will not give the well operator the right to enter your property.

Law Lesson

It is the policy of New York State to protect what is known as your “correlative right” to an opportunity to receive the benefits of drilling in a spacing unit that includes your acreage. For unleased owners, this opportunity is ensured by the compulsory integration process.

Before compulsory integration proceeds, the operator must attest to control of oil and gas rights for at least 60% of the acreage in a spacing unit. The spacing unit is established when DEC issues the well permit. Compulsory integration is necessary only if the well operator does not control 100% of the spacing-unit acreage.

For further research:

The Oil, Gas and Solution Mining Law is Article 23 of the Environmental Conservation Law. Article 23 includes the following sections that are related to the compulsory integration process:

Section 23-0301: The state’s policy on protecting the rights of oil and gas owners

Sections 23-0501 & 0503: Procedures for permitting wells and establishing spacing units

Section 23-0901: The election and compulsory integration process

Check out our other brochure, “A Landowner’s Guide to Oil and Gas Leasing”, for general information on leasing and basic lease terms at:
<http://www.dec.ny.gov/energy/1553.html>

To learn more about the Oil, Gas and Solution Mining Law, please visit:

<http://www.dec.ny.gov/energy/205.html>

For further information about what to expect or how to find information on specific existing or proposed spacing units, contact the Bureau of Oil and Gas Regulation at **518-402-8056**.



Division of Mineral Resources

Landowner’s Guide to Compulsory Integration Options



What happens if I don’t lease, but my acreage is assigned to a well?

David A. Paterson
Governor

Pete Grannis
Commissioner

What happens if I don't lease my oil and gas rights, but my acreage is assigned to a well?

Effective August 2, 2005, an applicant for a permit to drill an oil or gas well in New York State must include, in the permit application, a map showing the area that will be assigned to the well. This area, called a *spacing unit*, may include some or all of your acreage even if you haven't signed an oil and gas lease.

After the Department of Environmental Conservation (DEC) issues a well permit, you will be required to elect an option for how your unleased acreage in the spacing unit will be integrated with other properties in the unit. Your election will be finalized by issuance of a compulsory integration order after a public hearing. This process consolidates control and management of well operations with the well operator who holds the permit from DEC. If you have leased your oil and gas rights to someone else, then you are not required to make an election; your lessee will make the decision if necessary.

Each option presents different risks and potential rewards. The option you select may subject you to certain costs and obligations, and there is no guarantee that a well will make money. You should carefully consider all the implications of your decision. If no permit is issued, then your acreage will not be affected.

Compulsory Integration Options

If your acreage remains unleased but it is in a spacing unit, you must choose one of the following:

- Integration as a royalty owner
- Integration as a participating owner
- Integration as a non-participating owner

In most cases, you will be making this choice before the well is drilled and before you know whether the well will be a success that pays for itself, a marginal producer that never pays for itself, or a dry hole. Even if a well initially produces hydrocarbons, it is impossible to know in advance whether it will continue to produce for many years or for a very short time, such as a month or less. It is certain that the amount of oil or gas a well produces will decrease over time. The rate of decrease is another factor that cannot be predicted.

What To Expect

If DEC issues a well permit based on a spacing unit that includes your unleased tract, the following is what you should expect to happen before the hearing:

1. DEC will assign a hearing date when the permit is issued.
2. At least 30 days before the hearing, the well operator will send a notice directly to you. It will include the following:
 - Date, time and place of hearing
 - Proportion of your acreage to total acreage in spacing unit
 - Estimated well costs, including plugging costs because the well may not be successful
 - Election form for choosing your integration option
 - Draft integration order
3. You will have 21 days after receiving the form to make your election.
4. If you elect to be an "Integrated Participating Owner," payment for your share of the estimated well costs is due to the well operator by the hearing date.

After you receive the hearing notice and before the integration hearing, you still may enter into a lease or other private agreement regarding development of your oil and gas rights. If you establish an agreement with someone other than the well operator, you should provide the notice package to that person or company immediately.

Compulsory Integration hearings are held in Albany, New York on a regular schedule.

Get Good Advice

The benefits, costs and obligations of participating in an oil or gas well may affect you and your property for many years. Oil and gas exploration is a risky business. This brochure is not a substitute for legal or financial advice by knowledgeable professionals. DEC staff cannot advise you on which election to choose. You must judge for yourself how much risk you are willing to take and make an informed decision.

Integration as a Royalty Owner

Costs - If you elect this option, you are not liable for any charges or fees associated with well operation. A dry hole costs you nothing. This is the default option if you do not make a selection.

Compensation - If the well produces, the well operator will begin paying you a royalty shortly after production starts. The royalty will be no less than one-eighth of the revenue received by the well operator for the share of production attributable to your acreage. An integration order is not a "forced lease" and will not award you a signing bonus.

Integration as a Non-Participating Owner

Costs - If you elect this option, you will have the same responsibilities as a Participating Owner, but you do not risk your own money by paying your share of costs up front. A dry hole costs you nothing.

Compensation - You will not receive any compensation from the well operator, not even a royalty,¹ until the well operator has, through the sale of your share of production, recovered your share of the costs plus a "risk penalty" of 200% of your share of costs, for a total of 300%. This means that the well must pay for itself three times before you are compensated. After the well pays for itself three times, or if you buy out of the risk-penalty phase by making a payment, you will receive your share of production and be treated as a Participating Owner.

¹If you have leased to someone other than the well operator, then your lessee may owe you a royalty during the risk-penalty phase. This is determined by your lease, and the well operator has no obligation to you.

If your lessee elects to be integrated as a non-participating owner, then the well operator must make royalty payments to your lessee during the risk penalty phase. These payments will be on a graduated scale from 1/16 up to 1/8, based on the percentage of the lessee's costs that have been recovered through sale of production.

Integration as a Participating Owner

Costs - If you elect this option, you must pay your share of estimated well costs by the time of the integration hearing. This money will not be refunded if the well is a dry hole or does not pay for itself.

Compensation - You will receive your full share of production. However, the well operator will have a lien on your share of production to pay any outstanding amounts that you owe.

Responsibilities of Integrated Participating and Non-Participating Owners

A decision to be integrated as a participating or non-participating owner subjects you to obligations that do not enter the picture if you elect to be integrated as a royalty owner. Some of the additional considerations are as follows:

Actual well costs. The actual cost to drill or plug the well may exceed the estimate that was provided before the hearing. You will be held liable for your share of the additional costs.

Completion and operating costs. If the well is successful, it will cost money to complete and operate. You will be liable for your share of these costs for the life of the well.

Gathering line costs. If the well is a producer, the well operator will provide you with the estimated costs to install a gathering line to bring the gas to market. You will have the option of paying your share up front or having your share plus 100% withheld from your share of production proceeds.

Subsequent operations. The law defines certain operations in the spacing unit, including additional work on the existing well or drilling of another well, when you again must decide to either pay up front or be subject to a risk penalty. Subsequent operations may cost as much as or more than the original drilling.

Other liabilities. As an integrated participating or nonparticipating owner, you are liable for your proportionate share of taxes and third-party claims related to drilling and operation of the well.