

Ohio House Bill 133: New Opportunities for Oil and Gas Development on State Lands

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For more information about House Bill 133 or legal issues relative to Marcellus and Utica shale development in Ohio, please contact [Glenn Krassen](#) or [Matt Warnock](#) of Bricker & Eckler LLP, or visit the Bricker & Eckler [Marcellus and Utica Shale Resource Center](#).

The development of Marcellus and Utica shale offers the State of Ohio exciting new opportunities for oil and gas production, economic development and job growth. On March 1, 2011, State Representative John Adams introduced HB 133, which overhauled the process by which lands owned or controlled by the State of Ohio can be leased for oil and gas development. The Ohio House of Representatives passed an amended version of the bill on May 25, 2011, by a vote of 54-41. The Ohio Senate took up consideration of the bill the next day. After additional modifications were incorporated, the bill passed the Senate by a vote of 22-10 on June 15, 2011, and the House concurred with the Senate's changes on June 21, 2011, by a vote of 57-39. The bill was submitted to Governor John Kasich for his signature on June 24, 2011. A copy of the final bill can be found on the [Ohio Legislative Service Commission website](#).

HB 133 introduces a number of new concepts to Ohio. The following summary provides a detailed overview of these concepts along with an explanation of the new oil and gas leasing process for lands owned or controlled by the State of Ohio.

I. The Oil and Gas Leasing Commission

The most significant aspect of HB 133 is the creation of the Oil and Gas Leasing Commission (the "Commission"), which will oversee and coordinate the leasing of land owned or controlled by a state agency, state university or college for the exploration, development, and production of oil and gas. Previously, a number of state agencies, including the Department of Administrative Services, had the authority to independently enter into oil and gas leases. R.C. 127.01(17).¹ The creation of the Commission consolidates the leasing power in one governmental entity.

Commission Composition: The Commission will consist of five individuals, including the chief of the Ohio Department of Natural Resources ("ODNR") Division of Geological Survey (currently the State Geologist, Larry Wickstrom), and four others appointed by the Governor. Of the four gubernatorial appointees, two must be selected from a list of at least four individuals submitted by a statewide organization representing the oil and gas industry (e.g. the Ohio Oil and Gas Association); one must be a member of the public with expertise in finance or real estate; and one must represent a statewide environmental or conservation organization. The initial gubernatorial appointments must be made within 30 days of the effective date of HB 133. R.C. 1509.71(B) and (C).

Term of Service: With the exception of the chief of the Division of Geological Survey, the initial members of the Commission are appointed by the Governor for staggered terms of two, three, four, and five years respectively. Subsequent terms are capped at five years. R.C. 1509.71(C).

Official Commission Business: Under HB 133, three (3) members of the Commission constitutes a quorum. Actions of the Commission are not valid unless approved by a quorum. The Commission also must keep a record of its proceedings, with clerical, technical, legal, and other administrative support to be provided by ODNR. R.C. 1509.71(D) and (G).

Commission Rules: Within 270 days after its effective date, HB 133 mandates that the Commission establish rules that, among other things, address the following subjects:

- The procedure for nominating state lands for oil and gas leasing, including the contents of the nomination form (see below for more information on the nomination process);
- Nomination fees, which must be: (i) waiveable when the nomination is made by a state agency; and (ii) reimbursed if the nominating person does not enter into an oil and gas lease with the Commission;
- Factors the Commission may consider when approving or disapproving a nominated parcel;
- The procedures for submitting bids for an oil and gas lease;
- Bid fees; and
- The development of a standard lease with terms and conditions consistent with industry practices and including at least a one-eighth (1/8) royalty provision.

R.C. 1509.74(A)-(G).

II. Classification of State Land

HB 133 requires each “state agency” to take inventory of all lands it owns or controls and classify each parcel based on its suitability for oil and gas exploration and development. R.C. 1509.72(A). For purposes of HB 133, the phrase “state agency” includes “every organized body, office, or agency established by the laws of the state for the exercise of any function of state government” as well as state colleges and universities. See R.C. 1509.70(F) and R.C. 1.60.

The Four Classifications: HB 133 divides property owned or controlled by a state agency into four categories:

- “Class 1 property” is land for which there are no encumbrances or deed restrictions limiting the exploration or development of oil and gas. R.C. 1509.70(A).
- “Class 2 property” is: (i) land owned or controlled by a state college or university, or (ii) land owned or controlled by another state agency that is subject to a federal encumbrance or monetary interest limiting or prohibiting the exploration or development of oil and gas. R.C. 1509.70(B). NOTE: A state agency that has classified a parcel of land as Class 2 property must make reasonable and appropriate efforts to get the property re-classified as a Class 1 property. R.C. 1509.76.
- “Class 3 property” is land that constitutes Class 1 property, but is of insufficient size or shape to satisfy the minimum acreage for a drilling unit under Ohio law, and is necessary for pooling with other parcels for the creation of a drilling unit. R.C. 1509.70(C). NOTE: Class 3 property cannot be approved for leasing by the Oil and Gas Leasing Commission. R.C. 1509.73(B)(2). However, if a Class 3 property has been disapproved, the state agency that owns or controls the land can enter into a written unitization agreement that conforms to the lawful minimum acreage and distance requirements in order to re-classify the parcel of land. R.C. 1509.77.
- “Class 4 property” is land subject to a deed restriction limiting oil and gas exploration or drilling on the property. R.C. 1509.70(D).

R.C. 1509.70(A)-(D). The Department of Natural Resources is required to post a listing of each parcel owned or controlled by a state agency and the classification assigned to it on the ODNR website. R.C. 1509.72(C).

Deadlines for Classifying Lands: Although HB 133 does not establish a specific date by which lands currently owned by the state must be classified, there is a deadline for newly acquired parcels. No longer than 90 days after the acquisition of property by a state agency, the land must be classified. In addition, if state land is nominated for an oil or gas lease (through the process

described below), but has not been classified, the state agency has fifteen (15) days after the notice of the nomination by the Oil and Gas Leasing Commission to do so. R.C. 1509.72(B) and 1509.73(B)(1).

III. Nomination of State Lands for Oil and Gas Leasing

Nominations: HB 133 establishes a nomination process that begins the leasing process for oil and gas development. The nomination is a proposal to make a specific parcel available for oil and gas leasing purposes. HB 133 requires a nomination to contain certain information, and be in the format established by the rules of the Oil and Gas Leasing Commission. R.C. 1509.73(A)(2). 270 days after the effective date of HB 133, a person that is an "owner," and interested in leasing a parcel of state land for oil and gas exploration and development, may submit a nomination to the Oil and Gas Leasing Commission for consideration. R.C. 1509.73(A)(2). NOTE: A nature preserve (as defined R.C. 1517.01) cannot be nominated or leased for the exploration, development, or production of oil and gas. R.C. 1509.73(I).

As used in HB 133, the term "owner" is defined as person who has the right to drill on a tract or drilling unit, to drill into and produce from a pool, and to appropriate the oil or gas produced either for the person or for others, except that a person ceases to be an owner with respect to a well when the well has been plugged in accordance with applicable rules and orders. R.C. 1509.01(K).

ODNR is responsible for adopting rules regarding the nomination process. HB 133 requires ODNR to publish, on its website, notice of each nomination at least 21 days prior to the approval or disapproval of the Commission. The notice must identify the parcel of land that has been nominated and include information on how a person may submit comments to the Commission regarding that nomination. R.C. 1509.72(D).

Review by the Commission: Between 30 and 120 days after the receipt of a nomination, the Commission must conduct a meeting for the purpose of approving or disapproving the nomination. R.C. 1509.73(B)(1). The Commission must approve or disapprove a nomination within two (2) calendar quarters (approximately 6 months) after the receipt of a nomination. R.C. 1509.73(B)(4). Prior to either approving or disapproving a nomination, the Commission must notify the state agency that owns or controls the state land upon which an oil or gas lease would occur. The Commission must also notify the person that submitted the nomination of its approval or disapproval by certified mail. R.C. 1509.73(B)(3)-(4). If the Commission approves a nomination, it must notify the relevant state agency of its approval and permit the state agency to submit, within sixty (60) days, any special terms and conditions that must be included in the oil and gas lease. R.C. 1509.73(B)(5).

Criteria for Evaluating Nominations: The Commission must consider the following criteria in determining whether to approve or disapprove a nomination:

- The potential economic benefits (i.e. revenue stream) that would result from oil or gas operations if the nomination was approved;
- The compatibility of oil and gas operations with the current use(s) of the state land;
- Environmental impacts if the nomination was approved;
- Potential adverse geological impacts if the nomination was approved;
- Potential impact to visitors or users of the state land being nominated;
- For lands owned by a state college or university, the potential impact to college or university operations or equipment;
- Objections submitted to the Oil and Gas Leasing Commission by a state agency that owns or controls the nominated land;

Comments or objections submitted to the Oil and Gas Leasing

- Commission by Ohio residents or users of the nominated land; and

- Any other factors established in the rules of the Oil and Gas Leasing Commission.

R.C. 1509.73(B)(1)(a)-(i).

Offering of Formations for Leasing: If the Commission approves the nomination of state land classified as Class 1 property, it must offer each formation within that parcel for lease. R.C. 1509.73(B)(6). HB 133 identifies five (5) different formations available for leasing: (i) the distance from the surface of the land to the top of the Onondaga limestone; (ii) the distance from the top of the Onondaga limestone to the bottom of the Queenston formation; (iii) the distance from the bottom of the Queenston formation to the top of the Trenton limestone; (iv) the distance from the top of the Trenton limestone to the top of the Knox formation; and (v) the distance from the top of the Knox formation to the basement rock. R.C. 1509.70(E). If the Commission approves a nomination of either Class 2 or 4 property, it cannot offer for lease any formation unless previously approved by the state agency owning or controlling the land. R.C. 1509.73(B)(6).

Advertisement of Available Formations: HB 133 requires the Commission to advertise for bids for the leasing of formations on land subject to an approved nomination during the previous calendar quarter. Advertisements must be done each calendar quarter on ODNR's website. The advertisement must include the following:

- A description of the procedure for submitting a bid;
- A statement that a standard lease form containing terms and conditions consistent with industry practices will be used;
- A copy of the standard lease form;
- A list of any applicable special terms and conditions;
- The amount of the bid fee; and
- Any other information the Oil and Gas Leasing Commission believes is pertinent.

R.C. 1509.73(C). The deadline for submitting bids will be posted on ODNR's website R.C. 1509.73(F).

Confidentiality of Bids: The information contained in a bid submitted to the Commission is confidential and cannot be disclosed until after the winning bid is selected. R.C. 1509.73(E).

Highest and Best Bidder: The winning bidder for a formation is the person who submits the highest and best bid. Rather than focusing solely on the amount of the bid, this bidder evaluation standard allows the Commission to take into consideration the financial responsibility of the prospective lessee and the ability of the lessee to discharge the obligations set forth in the lease. Once the highest and best bidder is selected, the state agency must enter into a lease. R.C. 1509.73(F).

Temporary Authority for State Agencies to Enter into Oil and Gas Leases: Until the Oil and Gas Leasing Commission's rules take effect, state agencies are authorized to enter into oil and gas leases provided that they consult with the Oil and Gas Leasing Commission, and establish bid fees, signing fees, rental payments, and at least a one-eighth (1/8) royalty. R.C. 1509.73(A)(1).

IV. Allocation of Royalties from State Lands

HB 133 creates a number of new state treasury funds to deposit proceeds from oil and gas leases on state lands.

State Land Royalty Fund: In general, money earned from royalties, signing fees and rental payments must be deposited in the State Land Royalty Fund. Any proceeds from investments of the fund are credited to the fund. R.C. 131.50. State agencies are entitled to withdraw money from the State Land Royalty Fund in an amount equal to that contributed by the state agency as well as a proportionate share of the investments. For example, if 10% of the money in the State Land Royalty Fund are from lands leased by the Ohio Department of Transportation, then ODOT can use 10% of the money in the fund for certain purposes, including for the acquisition of land, and payment of capital costs including equipment, renovations, and repairs of facilities. 1509.73(G)(1).

Lands Controlled by ODNR: Money received from royalty payments, signing fees, and rental payments from oil and gas leases on land owned or controlled by ODNR are deposited into three new state treasury funds:

- For leases pertaining to the Division of Forestry, money is deposited into the forestry mineral royalties fund to acquire land and pay certain capital costs (e.g. equipment, renovations and repairs). R.C. 1503.012
- For leases pertaining to the Division of Wildlife, money is deposited into the wildlife habitat fund to acquire land and develop land for the preservation, propagation and protection of wild animals. R.C. 1531.33.
- For leases pertaining to the Division of Parks and Recreation, money is deposited into the parks mineral royalties fund to acquire land and pay certain capital costs (e.g. equipment, renovations and repairs). R.C. 1541.26.

R.C. 1509.73(G)(2).

State Parks: At least thirty percent (30%) of proceeds from a lease for the exploration and production of oil and gas within or under a state park must be deposited in the applicable state treasury fund that supports the state park, and used to fund capital improvements at that state park. R.C. 1509.78.

Oil and Gas Leasing Commission Administration Fund: All nomination fees and bid fees are paid into the Oil and Gas Leasing Commission administration fund, which is designed to be used to pay for the administrative expenses, as well as actual and necessary expenses of the members of the Oil and Gas Leasing Commission. R.C. 1509.73(H) and 1509.75. However, the members of the Commission are not compensated. R.C. 1509.71(F).

Footnotes

1. The Department of Natural Resources also had the authority to enter into leases for minerals on and under the Lake Erie bed, as well as oil and gas leases on lands controlled by its Division of Wildlife. Other agencies with the authority to enter into mineral leases on land they owned or controlled included the Departments of Mental Health, Rehabilitation and Correction, and Developmental Disabilities, as well as the board of trustees of a state university.

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