

PROPOSED LEASE FORM REVISIONS

STAFF RECOMMENDATIONS

As you know, the Staff throughout this year has been reviewing the existing State Lease form to identify any revisions which may be warranted to more prudently manage and better protect the state's interest in state-owned lands and water bottoms subject to mineral leases. We initially identified 17 provisions to be revised within or added to the existing lease form. Recall that input from industry and interested parties on the proposed recommendations was requested. Written comments were solicited and a meeting conducted with interested parties this past June. Last month, two 4-hour work sessions were conducted by staff to review all of the information gathered over the past year pertinent to the recommended revisions. The staff wishes to express their appreciation to Secretary Chustz, Chairman Arnold, Mr. Cordaro and Mr. Smith for their participation and input in these work sessions.

The Staff also wishes to express their appreciation to all of the individuals who thus far have provided input throughout this revision process. The industry representatives, landmen, brokers, attorneys and other interested individuals should know that their comments and concerns have been received and given thoughtful consideration. As you shortly will hear, comments from these individuals external to the Office of Mineral Resources have significantly influenced the final recommended revisions to the lease form. Indeed, the feedback from these interested parties has caused us to conclude that certain of the initially recommended revisions are unworkable and, in some instances, simply not necessary.

Our purpose today is to provide to you a status report of our efforts and to seek your approval for the path forward. We will advise you, in general terms, of our recommendations for the 17 proposed provisions. For those that the Board chooses to proceed with implementing, the Staff and Legal Counsel will carefully review the wording of the revisions and additions proposed. We want to ensure that each provision is precisely worded in a manner that will clearly state all aspects of each provision. Throughout the re-writing process, we intend to work closely with the members of the public and industry who previously expressed an interest in this project. We fully expect and welcome additional feedback through this process, from which a revised draft of the proposed lease form will be provided to the Board for consideration, comments, additions, deletions and revisions, as warranted.

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I now provide to you the Staff's recommendations regarding each of the provisions that have been under consideration for either revision or addition to the existing lease form.

1. **BONUS CLAUSE**

ISSUE: A process is needed for adjusting bonus and rental amounts when acreage calculation errors are timely discovered

Staff recommends that the Board not proceed with adding this provision to the lease form. This provision is not likely to result in benefit to the State and would be cost prohibitive to administer.

2. **RENTAL CLAUSE**

ISSUE: Lessees do not pay rental during years in which operations or production occurs across an anniversary date

Staff recommends that the Board not proceed with adding this provision to the lease form. A historical review of all leases dating back over the past ten years indicates that this provision is not needed to protect or further the State's interests.

3. **DEFERRED DEVELOPMENT CLAUSE**

ISSUE: Lessees pay no deferred development on acreage outside of an established unit during years in which operations or production occurs across an anniversary date

Staff recommends that the Board not proceed with adding this provision to the lease form. A historical review of all leases dating back over the past ten years similarly indicates that this provision would not provide an appreciable benefit to the State.

4. **DEEP RIGHTS**

ISSUE: Leases are not being fully developed at all depths

Staff recommends that the Board proceed with adding this provision to the lease form. The precise wording requires revision to clarify the timing of the release of deep rights and the definition of the depths to be retained.

5. **BONDING REQUIREMENTS**

ISSUE: There is a need for security for the payment for damages caused the Lessee and for performance of the lease obligations

Staff recommends that the Board proceed with adding a provision to address site restoration but that any such requirement not extend to the royalty obligations. The precise wording of this provision requires revision.

6. **OFFSET**

ISSUE: Language pertaining to the Lessee's responsibility to protect lease premises from drainage for an offsetting well(s) greater than 660 feet from the lease needs to be clarified.

Staff recommends that the Board proceed with adding this provision to the lease form. The precise wording requires revision to clarify the requirements when the offset well is drilled on an adjoining State lease.

7. **ROYALTY**

ISSUE: Current royalty provision is outdated and confusing

Staff recommends that the Board proceed with adding this provision to the lease form. Staff does not anticipate a need to revise the wording of this provision as originally proposed.

8. **SINGLE PAYOR**

ISSUE: It is difficult to determine if the state has been paid in full when there is more than one payor and those payors use different payment methodologies.

Staff recommends that the Board proceed with adding this provision to the lease form. Staff does not anticipate a need to revise the wording of this provision as originally proposed.

9. **TRANSFERS AND ASSIGNMENTS OF LEASE**

ISSUE: The state needs to ensure that lease obligations are fulfilled when a lease is transferred to another party

Staff recommends that the Board proceed with adding this provision to the lease form, except that Section "C", as originally proposed, be omitted at this time. The appropriateness of including Section "C", as drafted or with revisions, will need to be evaluated after the Board makes a decision regarding the proposed bonding requirement. Staff does not anticipate a need to revise the wording of the remainder of this provision as originally proposed.

10. **UNIT PLATS**

ISSUE: Lessees are not providing surveyed unit plats to OMR in a timely manner, which are used to determine the State's royalty share

Staff recommends that the Board proceed with adding this provision to the lease form. The precise wording requires revision to include a provision to permit the Lessee to obtain an extension of time to obtain the plat and include a notice requirement prior to imposition of a penalty.

11. **LESSEE REPORTING**

ISSUE: OMR staff needs information and data about lease operations to evaluate producing areas on leases

Staff recommends that the Board proceed with adding this provision to the lease form. The precise wording requires revision to include language to maintain the confidentiality of information as allowed by law.

12. **PLUGGING AND ABANDONING**

ISSUE: Lease premises need to be restored after operations have ceased

Staff recommends that the Board proceed with adding this provision to the lease form. The precise wording requires revision. Plans are to include language to permit the Lessee to seek Board approval for additional time for site restoration and to provide alternatives such as creating a site specific trust account. Additionally, consideration needs to be given to the requirements imposed by the Office of Conservation.

13. **FORCE MAJEURE AND SUSPENDING EVENTS**

ISSUE: Because of developing court decisions defining force majeure, it needs to be treated separately and differently from suspending events

Staff recommends that the Board proceed with adding this provision to the lease form. The precise wording requires revision to include language clarifying that the lease will not be subject to cancellation for failure to submit monthly reports.

14. **ENVIRONMENTAL LANGUAGE**

ISSUE: Environmental requirements in current lease form do not meet current industry standards

Staff recommends that the Board proceed with adding this provision to the lease form. The precise wording requires revision to include reference to legal citations relative to environmental concerns to ensure compliance with express law.

15. **GENERAL COMPREHENSIVE LIABILITY INSURANCE**

ISSUE: The state currently has no insurance to cover damage claims arising from operations on the leased premises

Staff recommends that the Board authorize the staff to further study this provision. Staff perspectives on this issue remain diverse.

16. **TITLE DISPUTES**

ISSUE: The proper procedure for satisfying royalty payment obligations in the event of a title dispute is presently unclear

Staff recommends that the Board proceed with adding this provision to the lease form. The precise wording requires revision to ensure that the requirements within the lease form fully comport with existing Board policy.

17. **AUDIT ACCESS RIGHTS**

ISSUE: Lessor's audit rights were not fully and clearly defined in the current lease form

Staff recommends that the Board proceed with adding this provision to the lease form. The precise wording of this provision as originally proposed is expected to remain substantially the same but for clarifying language to ensure the confidentiality of information as allowed by law.



This process admittedly has been ongoing for some time. The staff is committed to producing the best possible leasing document and we are willing to invest the amount of time required to do so. Our interest is in getting this right since the terms and provisions of the lease form will control leasing obligations and responsibilities for years to come.

We welcome any questions or comments you may have. Individual Board members with questions, concerns or feedback are encouraged to contact the Staff. We are available to meet with you at your convenience.