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SPECIFY PPCs IN GAS AND OIL LEASES

House Bill 4259 as introduced
First Analysis (12-3-97)

Sponsor: Rep. Tom Alley
First House Committee: Conservation, Environment and Recreation
Second House Committee: Forestry and Mineral Rights

THE APPARENT PROBLEM:

The mineral rights on private property are often leased to oil and gas companies. Typically, landowners receive one-eighth of the value of the oil or gas in royalty payments; the oil or gas company keeps the remaining seven-eighths. However, oil or gas companies may also deduct "post production costs" (PPCs) from royalty payments, and, lately, some royalty owners have claimed that PPC deductions have drastically reduced these payments. Moreover, in many instances, the oil or gas leases negotiated between the royalty owners and the oil or gas companies never specified that PPCs would be deducted from royalty payments. Accordingly, legislation has been introduced to restrict PPCs to those currently allowed in leases on state owned land, to block PPC deductions that are not specified in a lease, and to require full disclosure of a oil or gas producer's deductions (see HLAS analysis of House Bills 5261 and 5261). In addition, legislation has been proposed that would govern the conditions of lease agreements between mineral rights owners and oil and gas companies.

THE CONTENT OF THE BILL:

The bill would amend Subchapter 2 of Part 615 of the Natural Resources and Environmental Protection Act (NREPA), concerning the regulation of oil and gas wells, to specify that a person could not enter into an oil or gas lease as a lessee with the owner of private property unless certain provisions were included in the lease agreement in 12-point boldfaced type that was at least four points larger than the body of the agreement. These provisions include:

C The exact percentage of royalty interest entitled by the lessor, as determined by the value of the oil, gas, or related products extracted from the leased site, taking into account any standard or nonstandard expected deductions.

If any reductions in the royalties that would accrue to the lessor were allowed under the lease agreement d post costs (PPCs), a provision that the lessor would receive a detailed and itemized list of these PPCs.

C If postproduction deductions were provided for and agreed to by both the lessee and the lessor, the lease agreement would have to contain the definition of PPCs; specific areas of items eligible for deduction; a clear process enabling the lessee to monitor eligible deductions being charged; and a maximum percentage of costs to be deducted.

C If the possibility existed under the lease agreement that the lessor would have to pay the lessee in any given month for deductions for PPCs or other items, the lease would have to specifically state this possibility.

The bill would also specify that if a person had entered into an oil or gas lease as a lessee with the owner of private property within the state on the effective date of the bill, and the lease agreement or any subsequent agreement allowed for PPC deductions, the lessee would, within 90 days after the effective date of the bill, provide the lessor with all of the following: the definition of PPCs; specific areas of items eligible for deductions; a clear process enabling the lessee to monitor eligible deductions being charged; and a maximum percentage of costs to be deducted.

Penalties. A violation of the provisions of the bill would be a civil infraction, subject to a civil fine of up to $25,000. A default in the payment of a civil fine or costs ordered under the provisions of the bill, or an installment of the fine or costs, could be remedied by any means authorized under the Revised Judicature Act (MCL 600.101 et al.). In addition, the attorney general or other person could bring an action in circuit court for injunctive relief or damages, or both, against a person who violated these provisions.

MCL 324.61503a

FISCAL IMPLICATIONS:

According to the House Fiscal Agency (HFA), the bill would have no impact on state funds. (12-2-97)

ARGUMENTS:

For:
According to testimony presented in public hearings to members of the House Committee on Forestry and Mineral Rights, PPC deductions have reduced the royalty payments of some northern Michigan landowners who lease their mineral rights by one-half. In fact, according to the testimony of some, PPC deductions have exceeded the value of the royalty payments due the landowners. Moreover, most royalty owners weren't notified of companies' decisions to deduct PPCs and their oil and gas leases contained no provisions allowing for such deductions. Most participants in the issue agree that it is unfair that oil and gas producers should arbitrarily decide which PPCs they will deduct from royalty payments. The bill would resolve the problem by requiring that lease agreements conform to specific criterion. In addition, the bill would grant injunctive relief to petitioners in cases where lessees failed to comply with the criterion.

Against:
The provisions of the bill should not be placed under Part 615 of the Natural Resources and Environmental

Protection Act (NREPA). According to the Department of Environmental Quality (DEQ), to do so would have the effect of placing the provisions under the oversight of the supervisor of wells (the DEQ), and this was not the intent of the legislation. Also, it is pointed out that Part 615 of the act does not, strictly speaking, pertain to this type of legislation. Rather, Part 615 regulates the unnecessary waste of oil and gas resources.

Also, House Bill 4259 specifies that, if any reductions in royalties are allowed under a lease agreement due to PPCs, the lessee must provide the lessor with a detailed and itemized list of these PPCs. This provision would seem to overlap with a provision of House Bill 5262 which specifies, among other things, that a lessee must provide the lessor with monthly revenue statements that provided a specific itemized list of all deductions taken from the lessor's royalty.

Against:

As written, the bill would specify that, where PPCs had been agreed to by both the lessee and the lessor, a lease agreement entered into between a property owner and an oil and gas company would have to specify, among other provisions, a maximum percentage of costs that could be deducted. Similarly, a lessee would have to provide a lessor with this information in cases where a lease agreement had been entered into before the effective date of the bill. However, in previous testimony presented to the House Forestry and Mineral Rights Committee, private property owners complained that PPC deductions are often so excessive that, in some cases, they exceed the amount of the royalty payment. Some contend that the bill should include language restricting the percentage of PPC costs that could be deducted from royalty payments.

POSITIONS:

The Department of Natural Resources supports the bill. (12-2-97)

The Michigan Environmental Council supports the bill. (12-2-97)

The Michigan Land Use Institute supports the bill. (12-2-97)

The Michigan Farm Bureau supports the bill. (12-2-97)

The Michigan Oil and Gas Association opposes the bill. (12-3-97)

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