Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

SFA BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

House Bill 4280 (as passed by the House)
House Bill 4281 (Substitute H-1 as passed by the House)
Sponsor: Representative Larry DeVuyst
House Committee: Conservation and Outdoor Recreation
Senate Committee: Natural Resources and Environmental Affairs

Date Completed: 11-30-99

CONTENT

The bills would amend Part 615 of the Natural Resources and Environmental Protection Act (NREPA), which pertains to the regulation of oil and gas wells, to describe the postproduction costs that could be deducted from a lessor's royalties; to specify the provisions of a division order for the payment of royalties under a lease; and to impose penalties on a person who violated House Bill 4281 or Public Act 127 of 1998.

The bills would be effective 90 days after their effective date and are tie-barred to each other.

House Bill 4281 (H-1)

Postproduction Cost Deduction

A person who entered into a gas lease as a lessee after the bill's effective date would not be able to deduct from the lessor's royalty any portion of postproduction costs unless the lease explicitly allowed for the deduction of postproduction costs. If a lease provided for the deduction of postproduction costs, and unless the lease explicitly and specifically provided for the deduction of other items, the lessee could deduct postproduction costs only for the following items:

-- Removal of carbon dioxide, hydrogen sulfide, molecular nitrogen, or other constituents, except water, whose removal would enhance the value of the gas for the benefit of the lessor and the lessee.
-- Transportation after the point of entry into any of the following: an independent, nonaffiliated, third-party-owned pipeline system; a pipeline system owned by a gas distribution company or any subsidiary of the company, regulated by the Public Service Commission (PSC); or an affiliated pipeline system, if the rates charged by it had been approved by the PSC, or if the rates charged were reasonable, as compared to independent pipeline systems, based on the pipeline system's location, distance, cost of service, and other pertinent factors.

The bill also would prohibit a lessee from charging postproduction costs incurred on gas produced from one drilling unit, pooled or communitized area, or unit area against a lessor's royalty for gas produced from another drilling unit, pooled or communitized area, or unit area. ("Unit area" would mean the formation or formations that were unitized and surface acreage that was a part of the unitized lands, as described in a plan for unit operations that was the subject of an order of the Supervisor of Wells, or an applicable agreement providing for unit operations.)

A person who entered into a gas lease as a lessee before or after the bill's effective date, and who charged the lessor for any portion of postproduction costs would have to notify the lessor in writing of the availability of a specific itemized explanation of all postproduction costs to be assessed. If the lessor requested this information, the lessee would have to provide it.

Division Order

A division order or other document from a lessee that included provisions stipulating how production proceeds were distributed would not alter or define the terms of a lease, unless it was voluntarily and explicitly agreed to by both parties in a signed document or documents in which the parties expressly indicated their intention to amend the lease. Except as provided in the bill, a lessee could not precondition the payment of royalties upon the lessor's signing such a document. As a condition for the payment of royalties under a lease, other than one granted by the State, a lessee or other payor would be entitled to receive a signed division order from the payee, containing only the following provisions, unless others had been voluntarily agreed to by both parties in a signed document or documents that expressly indicated their intention to waive these provisions:

-- The effective date of the division order.
-- A description of the property from which the oil or gas was being produced, and the type of production.
-- The fractional or decimal interest in production, or both, claimed by the payee; the type of interest; the certification of title to the production share claimed; and, unless otherwise agreed to by the parties, an agreement to notify the payor at least one month in advance of the effective date of any change in the interest in production owned by the payee, and an agreement to indemnify and reimburse the payor for payments made if the payee did not have merchantable title to the production sold.
-- The authorization to suspend payment to the payee for production until the resolution of any title dispute or adverse claim asserted regarding the interest in production being claimed by the payee.
-- The name, address, and taxpayer identification number of the payee.
-- A statement that the division order did not amend any lease or operating agreement between the interest owner and the lessee or operator, or any other contracts for the purchase of oil or gas.

Repealer

The bill would repeal the tie-bar provision of Public Act 127 of 1998. The Act proposed to add Section 61503a to the NREPA to require the lessee on a gas production lease to provide the lessor with monthly revenue statements itemizing deductions taken from the lessor's royalties and listing the unit price received by the lessee for gas sold, and to have an annual financial audit of the lessee's operations. The Act was tie–barred to House Bill 4259, which was not enacted. As a result, Public Act 127 has not taken effect.

House Bill 4280

Penalties

A person who knowingly violated Section 61503a (the section created by Public Act 127 of 1998) or House Bill 4281 would be subject to a civil fine of up to $1,000. A default in the payment of a civil fine or costs ordered under this provision, or an installment of the fine or costs, could be remedied by any means authorized under the Revised Judicature Act. The Attorney General or the lessor of a gas lease could bring an action in circuit court for injunctive relief or damages, or both, against a person who violated Section 61503a or House Bill 4281.

Further, if a person who had entered into a gas lease as a lessee violated Section 61503a or House Bill 4281, each day the violation continued would constitute a separate offense for five days only; each day thereafter, it would not constitute a separate offense. If a person who had entered into a gas lease as a lessee violated Section 61503a or House Bill 4281, and the violation would affect more than one lessor having an interest in the same well, pooled unit, or unitized area, the violation as to all lessors would constitute only one offense.

Recovery

If a court found that a lessee had deducted postproduction costs from a lessor's royalty contrary to House Bill 4281, the lessor could recover as damages the amount deducted contrary to House Bill 4281. In addition, a party who prevailed in litigation could recover reasonable attorney fees that were incurred in bringing an action if the court found that the position taken by the nonprevailing party was frivolous.

A person could not bring a court action unless the person had first given the lessee written notice of the alleged violation of Section 61503a or House Bill 4281, with reasonably comprehensive details, and allowed a period of at least 30 days for the lessee to cure the alleged violation.

Proposed MCL 324.61503b (H.B. 4281) Legislative Analyst: N. Nagata
Proposed MCL 324.61503c (H.B. 4280)

FISCAL IMPACT

The bills would have no fiscal impact on State or local government.

Fiscal Analyst: P. Graham

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.