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House Bill 5709 (Substitute H-2 as reported without amendment)
Sponsor: Representative Larry DeVuyst
House Committee: Conservation and Outdoor Recreation
Senate Committee: Natural Resources and Environmental Affairs

Date Completed: 11-20-00

RATIONALE

Landowners and others who own mineral rights in a "prospect" area may lease drilling rights to oil and gas companies. A lease gives a company the right to enter the property in order to explore, develop, and extract oil and gas from it. Lease contracts may designate rental payments and royalty percentages, as well as provide for the deduction from royalty payments of postproduction costs (such as charges for transportation and natural gas processing).

The deduction of post production costs is governed by the Natural Resources and Environmental Protection Act. If a court finds that an oil or gas company deducted postproduction costs from a lessor's royalty in violation of the Act, the lessor may recover damages in the amount of the improperly deducted postproduction costs, and a party who prevails in litigation may recover reasonable attorney fees incurred in bringing the action, if the court finds that the position taken by the nonprevailing party was frivolous. Some people believe that the current standard for the recovery of reasonable attorney fees is too severe.

CONTENT

The bill would amend Part 615 of the Natural Resources and Environmental Protection Act, which pertains to regulation of oil and gas wells, to revise provisions concerning the recovery of attorney fees in litigation over the deduction of postproduction costs.

Under the bill, if a court found that a lessee had deducted postproduction costs from a lessor's royalty contrary to the Act, the lessor could recover reasonable attorney fees incurred in bringing the action unless the lessee endeavored to cure the alleged violation before the action was brought. The bill also specifies that a lessee could recover reasonable attorney fees incurred in defending the action if the court found that the lessor's position was frivolous. These amendments would replace the

current provision under which a prevailing party may recover reasonable attorney fees if the nonprevailing party's position was frivolous.

Under the Act, a person who enters into a gas lease as a lessee after March 28, 2000, may not deduct from the lessor's royalty any portion of postproduction costs unless the lease explicitly allows for the deduction. If a lease specifically provides for the deduction of postproduction costs, the lessee may deduct only items specified in the Act, unless the lease explicitly provides for the deduction of other items.

MCL 324.61503b & 324.61503c

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The bill would make the standard for awarding attorney fees in postproduction cost litigation fairer to both parties. Currently, before awarding attorney fees to a lessor (the mineral rights owner), the court must find that the lessee's position was frivolous. This can make the recovery of costs difficult for a landowner, who may have few resources to devote to litigation compared with a large corporation. Under the bill, a court could award attorney fees to a lessor without finding that the lessee's position was frivolous. At the same time, however, the bill would give a lessee the opportunity to avoid paying costs by attempting to cure the violation before an action was brought. Furthermore, the bill would make it clear that a lessee also could recover attorney fees if a lessor's position was frivolous, which would discourage mineral rights owners from bringing unwarranted litigation.

Supporting Argument

The bill would improve a lessor's confidence in the leasing process and improve the relationship between mineral rights owners and oil and gas companies by encouraging the companies to attempt to cure disputed deductions before any litigation occurred. This would promote the State policy, expressed in the Act, "...to foster the development of the industry...with a view to the ultimate recovery of the maximum production of these natural products" (MCL 324.61052). According to the Michigan Oil and Gas Association, this State is one of the nation's major sources of oil and gas, having produced more than a billion barrels of crude oil and over 4 trillion cubic feet of natural gas since the State's first commercial oil field was discovered in Saginaw in 1925. The Association also reports that, since 1976, the industry has contributed to the Michigan Natural Resources Trust Fund more than \$550 million in oil and gas revenue from State-owned land and mineral rights. Clearly, the oil and gas industry is important to Michigan's economy, and it is necessary that developers and mineral owners have a good working relationship.

Legislative Analyst: N. Nagata

FISCAL IMPACT

The bill 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.