

**OIL & GAS LEASES:
REVISE UNITIZATION APPROVAL**

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Senate Bill 903 as reported without amendment
Sponsor: Sen. Tom Casperson
House Committee: Energy Policy
Senate Committee: Natural Resources
Complete to 9-21-16

Analysis available at
<http://www.legislature.mi.gov>

(Enacted as Public Act 316 of 2016)

BRIEF SUMMARY:

Before a DEQ order can become effective that approves a plan combining oil and gas leases in a producing field for operation as a single unit (unitization), approval must be obtained in writing from affected persons liable for payment of costs or entitled to proceeds under the unitization. The bill would lower the threshold for approval of the plan by affected parties, as explained in more detail later.

BACKGROUND:

"Pooling" of gas and oil leases refers to the practice of combining all oil and gas interests in a drilling unit. For instance, Landowner A may lease a certain number of acres to a developer, and a neighbor, Landowner B, may lease acres to the same or to a different oil or gas company or developer.

Pooling satisfies several concerns. The primary purpose is to provide a process for oil and gas development that is equitable and efficient. It prevents the unnecessary drilling of wells that can occur if each landowner of a separate tract of land in an area known or suspected to have reserves of gas or oil were allowed to drill a well on his or her tract. Since oil and gas reserves are fluid, meaning they move and shift within a geologic formation, and can be drained from one or more access points anywhere in the geologic structure, the oil or gas under landowner A's tract today may move tomorrow, or be pumped by a well on landowner B's tract. Thus, pooling also protects a landowner from having the gas or oil on his tract drained without compensation. (The above information provided by the DEQ document "Pooling of Properties for Oil and Gas Production" available on the agency's website: https://www.michigan.gov/documents/deq/ogs-oilandgas-pooling_257974_7.pdf)

"Unitization" refers to a legal process by which landowners, owners of wells, and owners of rights in a producing field may combine their interests. Unitization enables a single pool or one or more pools to combine into a unit that provides greater flexibility of well placement or spacing to increase efficiency and/or allows for enhanced oil recovery methods to be used (e.g., injection wells in which water or other substances such as carbon dioxide is injected into the well to enable amounts too small to extract using traditional extraction practices to be recovered).

Under the Natural Resources and Environmental Protection Act (NREPA), the Department of Environmental Quality is charged with providing for the orderly and efficient development of the state's oil and gas resources. In fulfilling these duties, the DEQ must also prevent damage to other resources, the environment, and must protect the public's health and safety. Thus, unitization generally requires oversight and approval by the Supervisor of Wells. Part 617 of the NREPA sets forth the approval process for a plan of unitization.

DETAILED SUMMARY:

Senate Bill 903 amends the Natural Resources and Environmental Protection Act, Article III (Natural Resources Management), Chapter 3 (Management of Nonrenewable Resources), Subchapter 2 (Regulation of Oil and Gas Wells), Part 617 (Unitization).

Generally speaking, before a drilling area may be "unitized," a petition must be filed with the Department of Environmental Quality (DEQ) and approved by the Supervisor of Wells (defined to mean the department). Certain information is required to be included with the petition and the process includes notification to all interested parties and a time period in which an affected party may file any concerns (protests); a public hearing is required if one or more protests to the unitization petition is or are received. A petition for unitization must be granted if the Supervisor finds the following:

- That the unitization requested is reasonably necessary to substantially increase the ultimate recovery of oil and gas from the unit area.
- That the type of operations contemplated by the plan are feasible, will prevent waste, and will protect correlative rights.
- That the estimated additional cost of conducting such operations will not exceed the value of the additional oil and gas so recovered.

The unitization plan must also be approved by those persons who would be entitled to certain minimum percentages of the costs and revenues under the plan.

Currently, before an order of the Supervisor providing for unit operations can be declared or become effective, the unitization plan must be approved *in writing* in one of the following ways:

- ❖ By those persons who under the Supervisor's order will be required to pay at least 75 percent of the costs of unit operation (**the bill decreases this to 51 percent**), and also by those entitled to at least 75 percent of the production from the unit area or the proceeds of that production that will be credited to interests free of cost; for instance, royalties and production payments (**the bill decreases this to 51 percent**).
- ❖ By those persons who under the order will be entitled to at least 75 percent of all production from the unit area or the proceeds of that production, provided that among those persons there must be some entitled under the order to at least 50 percent of the production from the unit area or the proceeds of that production that

will be credited to interests that are free of cost, including royalties and production payments. (The bill does not amend this provision.)

- ❖ By those persons who under the order will be entitled to at least 90 percent of all production from the unit area or the proceeds of that production (**the bill decreases this to 65 percent**).

The bill also updates language for clarity in a section establishing the petition requirements for a request for a unitization order.

MCL 324.61703 and 324.61706

BRIEF DISCUSSION OF THE ISSUES:

As described above, unitization enables a production field to be operated as a whole, with only one operator running it, even if multiple landowners, owners of wells, and owners of mineral rights hold interests in a producing field. Often, the project involves using modern techniques, such as using carbon dioxide, to flush out smaller amounts of oil from abandoned or dormant wells that cannot be retrieved by conventional drilling methods. By some estimates, use of injection wells could recover in excess of 10 million barrels from older, dormant wells just in Northern Michigan. However, Michigan law currently requires approval of a supermajority of those holding an interest in the field before a project can go forward. Industry members would like to see the threshold lowered to a simple majority.

Supporters say the bill will mean that a small minority could not block a project that has the support of almost all the rest of the affected parties. It also means, they point out, that the inability of a developer to track down ownership of a piece of field will no longer kill a project. Since unitization is often used to extract leftover gas and oil from wells capped decades ago, some dormant since the 1930s, it can be difficult if not impossible to locate a current owner. A developer would still have to follow statutory requirements regarding trying to identify and notify a current owner, holding that person's or persons' share of the earnings for the required time period, and eventually transferring the money to the state as unclaimed property. The higher approval thresholds date back to the 1950s and to a time when gas and oil exploration was still a new industry. Industry members feel such caution is no longer needed and the bill will bring Michigan law in line with nearby states such as Tennessee, Kentucky, Idaho, and Illinois.

FISCAL IMPACT:

SB 903 Oil & Gas Well Unitization

The fiscal impact of Senate bill 903 is unknown. The proposed changes to the current unitization standards may serve to encourage the pursuit of additional oil production, which could increase oversight and monitoring costs for DEQ while simultaneously increasing the corresponding revenue realized from additional surveillance fees and severance taxes. However, it is unclear whether the changes proposed in SB 903 will indeed lead to increased oil production. Factors external to statute, primarily the fluctuating market price of oil, also play a role in determining whether additional oil production is pursued

regardless of unitization thresholds. Consequently it is unclear whether DEQ's costs or revenues would be affected by SB 903. This bill would not have a fiscal impact on local units of government.

POSITIONS:

A representative of Core Energy, LLC testified in support of the bill. (9-7-16)

A representative of Loomis Law Firm testified in support of the bill. (9-7-16)

Michigan Oil and Gas Association indicated support for the bill. (9-7-16)

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.