

MICHIGAN DEPARTMENT OF NATURAL RESOURCES	PROCEDURE	No. 2306.J6
	FOREST, MINERAL AND FIRE MANAGEMENT MINERAL AND LAND MANAGEMENT SECTION	DATE: July 28, 2004

SUBJECT: Oil and Gas Lease Drainage Procedure

POLICY: It shall be the policy of the Natural Resources Commission to manage State-owned minerals in a manner that protects and enhances the public trust. Surface and mineral ownership may be consolidated when it is in the best interests of the State. Minerals shall be developed in an orderly manner to optimize revenue consistent with other public interest and natural resource values.

PURPOSE: Whereas it shall be the policy of the Forest, Mineral and Fire Management (FMFM) and the Director of the Department of Natural Resources (Department) to require each Lessee to be in full compliance with all statutes, rules, policies, procedures and lease covenants, express or implied, governing the Oil and Gas Leasing Program administered by the Department, a procedure shall be in place to provide the Lessee notice of potential drainage and an opportunity to correct the Lease infraction(s).

All State of Michigan Oil and Gas lease versions address drainage of the State’s minerals from adjacent leasing activities. The Lessor’s reservations regarding drainage have been expressed in various locations of the State leases over the years, with the current language specified under Paragraph J6. Paragraph J6 states that “The Lessor reserves the right to require the Lessee to drill and operate wells to offset producible wells on adjoining production units when the Lessor believes drainage is occurring, regardless of whether such adjoining units are owned or leased by the Lessee. If, within one hundred twenty (120) calendar days from the date notification from the Lessor is mailed pursuant to E(1), the Lessee fails to: commence drilling such offset well(s), or agree to payment of and to commence payment of commensurate royalties on a monthly basis, or to submit reasonable proof to the Lessor that drainage is not occurring, the Lessor may require the Lessee to surrender a portion of the leased premises necessary to establish a Drilling Unit(s) for the drilling of offset wells. Offset wells shall be drilled to a depth not less than that of the producing formation of the adjoining well and the drilling of such offset well or wells shall be prosecuted to completion in good faith. In the event the Lessee elects to make payment of commensurate royalties, the Lessee shall provide the Lessor with information in the Lessee’s possession relevant to determination of said royalties”.

RELATED PROCEDURES: Mineral Lease Compliance Procedure No. 2306.E8
Mineral Lease Bonds – Invoking/Collection Procedure No. 2306.E7
Mineral Lease Forfeiture Procedure No. 2306.E9.

WHO	DOES WHAT
Mineral and Land Management Section (MLMS Staff)	<ol style="list-style-type: none"> 1. Discovers possible offset drainage of State-owned leases through periodic review for offset production, Oil and Gas Lease Auction Nominations, personal communication or various other methods. 2. Collects evidence which may include: <ol style="list-style-type: none"> a. Specific Lease requirements regarding potential drainage and timeframe for responding to the State’s notification. b. Map of local area surrounding lease. c. Geologic and production data to substantiate drainage. 3. Makes telephone contact with Lessee concerning the drainage situation. 4. Sends follow-up letter to Lessee requesting a written response, within 30 days, as to plans for drilling, inclusion of lease in unit or dropping of the lease. 5. Enters Lessee’s name, lease location, adjacent unit(s) and related information into the Drainage Tracking Table. 6. Monitors the Lessee’s actions for 30 day response and updates status on the Drainage Review Log. 7. Reviews status with Section Supervisor and makes recommendations as to Lessee’s proposal.

	<p>8. If no response, follows Procedures for Mineral Lease Compliance (No. 2306.E8), sending Notice of Noncompliance (NONC), by certified mail, to Lessee. Identifies date for achieving compliance with specific Lease covenant (current language is 120 days from the date the letter is mailed; older leases may need three additional days mailing time).</p> <p>NONC letters addressing drainage of State minerals shall include references as to resolving the noncompliance in the following manner:</p> <p>A. Commence drilling of an offset well to prevent continued drainage of State-owned hydrocarbon resources or,</p> <p>B. Commence monthly commensurate royalty payments to the State of Michigan based upon the following formula: number of wells with average monthly production of ___ Mcf gas, and/or ___ barrels of oil, multiplied by the average monthly posted price in the Michigan Oil and Gas News' weekly publication for Michigan Sweet and the base Gas prices from http://www.oilenergy.com/1cashpet.htm#gaso, multiplied by the lease royalty rate. Subsequent monthly payments will be due by the 25th of each month or,</p> <p>C. Provide the Department with reasonable proof that drainage of State-owned hydrocarbon resources is not occurring.</p> <p>The NONC shall also include reference that "should Lessee fail to resolve this drainage issue as outlined and required above, the Lessor will require immediate release of the State Lease. Should Lessee fail to resolve the drainage issue as outlined above, or fail to release the identified acreage from the lease, in accordance with lease terms and conditions the 'Lessor may invoke part or all of the performance bond when it determines that part or all of the covenants conditions or agreements specified in the lease are not being fulfilled...'. In addition, 'if Lessee fails to voluntarily satisfy the claim of default as herein provided, relative to rental, royalty, offset wells and any other express or implied covenants of this lease, the Lessor may proceed, at its sole discretion, with forfeiture of all or part of said leased premises in accordance with...' applicable statutes." (Language for specific lease version may be somewhat different and should be used in lieu of the above.)</p> <p>Additional reference to the Lessor's ability to place the Lessee, principal partners and all associated companies on the Hold Action list is to be included. Placement on the Hold Action list may result in the Lessee, principal partner and all associated companies being barred from any further leases, assignments, easements, extensions or other approvals by the Department.</p>
Section Manager	<p>9. Reviews MLMS Staff recommendations and determines if Lessee's proposal is acceptable.</p> <p>10. Notifies MLMS Staff of decision and requests applicable response to Lessee to be mailed.</p>
MLMS Staff	<p>11. Prepares notice to Lessee regarding acceptance of proposal; copying MLMS Section Manager and Unit Supervisors.</p> <p>12. Monitors Lessee's compliance to agreed upon proposal; notifying applicable MLMS staff when compliance is achieved.</p> <p>13. If applicable, requests Lessee to release the lease or initiates steps to forfeit the lease as outlined in the Mineral Lease Forfeiture Procedure (No. 2306.E9).</p> <p>14. If applicable, implements Lease Compliance Procedures following steps identified under Item 8 of this Procedure.</p>