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This newsletter is intended for landowners and other members of the public with interest in the oil and gas industry. Each newsletter is also posted on our website at [www.msue.msu.edu/oilandgas](http://www.msue.msu.edu/oilandgas). If you would like to be added to the e-mail list to receive this newsletter, please contact the editor. You can also contact your local MSU Extension Office to obtain copies of the newsletter and other free oil and gas leasing information.

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### **State Of Michigan May 8, 2012 Oil And Gas Lease Auction Results**

By: Curtis Talley Jr. Farm Management Educator Michigan State University

Sixteen bidders were successful in acquiring the right to lease State of Michigan owned mineral rights in 21 Lower Peninsula counties. The minimum bid was \$12 per acre.

Barry County had the most interest with 23,419 acres nominated by the industry. Meridian Energy of Haslet, Michigan was the successful bidder for this acreage paying an average of \$67.20 bonus per acre.

Oakland County, with 18,347 acres was second in interest. The high bidder for the entire acreage was Jordan Development with an average bonus bid was \$33.60 per acre. Jordan was high bidder on approximately 22,000 acres, which ranked them first in lease acreage won at the auction. Of note is that all of the acreage in Oakland County was designated as non-development. A non-development lease requires there be no surface disturbance, so a well site, storage tanks, roads, etc. are not allowed. Utilizing directional and horizontal drilling

technology, the minerals can be harvested from underneath by placing the drilling site on nearby land that does not have a non-development stipulation in the oil and gas lease.

Devon Energy of Oklahoma City was represented by three bidders at the auction. They were high bidder for the right to lease a total of 18,385 acres in Arenac, Clare, Gladwin, Mecosta and Ogemaw counties. Devon has begun an exploration program in Michigan, which is discussed in another article in this issue.

Rounding out the top five in acreage were Livingston with 14,561 acres and an average bonus of \$11.83/acre, and Gladwin with 11,627 acres and an average bonus of \$9.01/acre.

A new name at the auction was Pteradon Energy, LLC who will lease a little more than 11,000 acres at an average of \$14.73 per acre. The auction results can be viewed at: [http://www.michigan.gov/documents/dnr/MAYSUMMARY\\_385851\\_7.pdf](http://www.michigan.gov/documents/dnr/MAYSUMMARY_385851_7.pdf)

The State of Michigan receives a 1/6 royalty and the lease contains other provisions not found in the standard oil and gas lease. To view the State of Michigan lease go to [www.msue.msu.edu/oilandgas](http://www.msue.msu.edu/oilandgas) or contact your local extension office.

## **Can Local Governments Regulate Oil And Gas Development?**

By Dean Solomon and Kurt Schindler, Michigan State University Extension

Michigan communities are considering their roles in regulating oil and gas development through zoning. Just what Michigan's laws permit local governments to regulate is complicated.

Currently, a lot of attention is being paid to oil and gas development in Michigan. Rising oil prices are leading to increased drilling activity in some parts of the state, especially Lenawee and Jackson counties. Controversy surrounding hydraulic fracturing (fracking) technology is causing local officials in many areas of the state to consider their role in regulating the industry.

So what powers do cities, villages, townships and counties have to regulate oil and gas development through zoning? The answer is that while local governments cannot regulate oil and gas development there are exceptions.

First, it is important to separate two types of activities: (1) exploration, drilling and development that occur at the well site; and (2) processing, refining and transportation that happen at other locations. In the first type, townships and counties are pre-empted by Michigan's Zoning Enabling Act from regulating the drilling, completion, operation, abandonment and location of oil and gas wells and other wells associated with oil and gas exploration. Regulatory authority for oil and gas wells is within the Michigan Department of Environmental Quality Office (DEQ) of Oil, Gas and Minerals. Although DEQ informs municipal clerks of drilling activity, the

township and county have no direct regulatory role. Also, exclusive regulatory authority is assigned to the DEQ in the oil and gas part of the Michigan Natural Resources and Environmental Protection Act – leading some to question if village and city regulation is also pre-empted.

At some point the above activities end, usually after the product leaves the drilling site and before it flows into a Michigan Public Service Commission regulated pipeline. At that point, townships, villages, cities, and counties can regulate the processing, refining, and transport of oil and gas. Just exactly where activities that are pre-empted from local control end and those subject to zoning begin is debatable and must be handled on a case-by-case basis. One rule of thumb is that the drilling, completion and operation ends at the point the meter is placed that measures how much gas and oil comes out of the well for purposes of paying royalties to the mineral owner.

So where does this leave local government? How do they handle citizen concerns about oil and gas development impacts in their community?

Some communities are fairly aggressive, using zoning district and special use standards to limit oil and gas processing. Others take a relatively hands-off approach, or actively plan and zone areas for oil and gas industry support services. Just as with other land use issues, determining which regulatory methods make most sense should follow careful planning. Industry expansion projections, proximity of prime oil and gas processing locations to sensitive natural resources, residential areas, and transportation networks are important considerations. Another limiting factor is that drilling, processing and transportation infrastructure for oil and gas must be placed near where the resource is found. Where oil and gas is found may not always adhere to the plan and zoning map desires for a community.

Communities should always consult their municipal attorney before considering zoning approaches to oil and gas development regulation. For more information about oil and gas development in Michigan, see [www.msue.msu.edu/oilandgas](http://www.msue.msu.edu/oilandgas).

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## **Devon Energy Explores A-1 Carbonate and Utica-Collingwood in Michigan**

From the Michigan Oil and Gas News and Curtis Talley Jr.

Devon energy recently released results of its first test well, the Cronk 1-24-HD1 to its investors. This is a test of the A-1 Carbonate formation in Gladwin County. In this report, the well showed a promising estimated recovery of 800,000 to 900,000 million barrels of oil equivalent (MBOE), of which 55% is liquids. They projected an initial production rate of 800 to 900 barrels of oil equivalent per day (BOED) and an average royalty of 17%. Devon is also drilling another well in Gladwin County into the A-1 Carbonate, the Wiley 1-18 HD-1.

Devon recently proposed what is thought to be its first Ordovician Utica-Collingwood test in Michigan by filing a drilling permit application for the State Richfield 1-27P pilot hole and the planned State Richfield 1-34HD1 horizontal drain hole. Both of these wells are being drilled from a surface location in Section 27 of Roscommon County's Richfield Township, T22N-R1W. Devon reported that its net Michigan leasehold is currently 240,000 acres.

Because natural gas prices have reached 10 year lows and inventories in underground storage are at all time highs for this time of year, oil and gas exploration companies are more interested in liquids and crude oil than dry natural gas. Natural gas prices have declined from a peak of \$13/MMbtu in 2008 to \$2.01/MMbtu recently, a decline of 646%. Crude oil prices have declined from a peak of \$147/barrel in 2008 to \$96/barrel now, or 34%. As a result, the industry is currently looking for oil, natural gas liquids and condensate.

## **MICHIGAN OIL AND GAS LEASES: ENVIRONMENTAL LIABILITY**

Attorney William A. Horn, *Mika Meyers Beckett & Jones PLC*

A Michigan landowner who is asked to sign an oil and gas lease may wonder what environmental or regulatory obligations are created simply by signing the lease. This question is particularly relevant where it is anticipated that oil and gas operations will be conducted on the surface of the landowner's property.

Regulatory authority over oil and gas operations is granted to the Michigan Department of Environmental Quality pursuant to the provisions of Part 615 of the Natural Resources and Environmental Protection Act ("NREPA"). While the statutory provisions and administrative rules are detailed and comprehensive, no provision places responsibility or liability on a lessor who has signed an oil and gas lease.

Michigan also has a detailed and comprehensive regulatory program addressing the liability associated with owning and operating property, which is or becomes contaminated. These provisions are set forth in Part 201 of NREPA and its administrative rules.

Being a party to an oil and gas lease does not create environmental liability for the lessor.

Under MCL 324.20126(3) (d), “a person who owns severed subsurface mineral rights or severed subsurface formations or who leases subsurface mineral rights or formations” is not liable for the cleanup of the environmental contamination unless that person is responsible for an activity causing the release of the contamination into the environment.

While Michigan law sets forth detailed and comprehensive provisions regulating oil and gas operations, as well as the liability associated with owning or operating property which may be contaminated, signing oil and gas lease does not create regulatory or environmental obligations for the lessor under these provisions.

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### **Compulsory Pooling and the Landowner Not Willing to Lease**

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Deck: Can a mineral rights owner still receive a royalty even though they have not signed an oil and gas lease? The answer is yes. For those mineral rights owners that are hesitant to lease for oil and gas production, compulsory pooling provides an option that some landowners find appealing.

Leasing oil and gas mineral rights is a choice, not an obligation. Some landowners are anxious to lease because the potential for cash royalty payments is present. Other landowners may not want to enter into an oil and gas lease because the potential impacts to their existing business are not compatible with their long term goals.

“I have had a number of landowners ask about compulsory pooling because they had been told that if they did not sign the standard lease being offered, they would “ruin it” for their neighbors that had signed a lease”, said Curtis Talley Jr., Michigan State University Extension Farm Management Educator. Other questions dealt with the statement that if the landowner did not sign the lease, the State of Michigan would take legal action and require them to be compulsory pooled, so they might as well go ahead and sign the standard lease they were being offered. The implication was compulsory pooling was a very negative thing for a landowner not wanting to lease and the standard lease was a better deal.

One of the reasons for compulsory pooling is to allow for equitable and efficient development of oil and gas, while preventing the drilling of unnecessary wells. Let's use an example. You own 160 acres and your neighbor owns 80 acres. Your neighbor has leased his mineral rights, but you choose not to. The drilling company needs 40 acres of your land and an adjacent 40 acres of the neighbor's land to obtain a drilling permit for the depth and geologic formation they are targeting to harvest. Without your being under some type of lease or compulsory pool, it prevents your neighbor from receiving any royalty because the oil company does not have the 80 acres under lease to obtain the permit to drill the well. To allow the oil and gas development and drilling of the well, the oil and gas company can apply to the Supervisor of Wells for a Compulsory Pooling order. The compulsory pooling order is the remedy, so that the oil company can drill the well, the neighbor can obtain the royalty and even though you are not under a lease, you will receive a royalty also.

The compulsory pooling order may include a lot of language that is not applicable to an unleased mineral owner. For the unleased mineral owner that does not choose to be an investor in the well, the order will consist of:

1. It will deal with only the well in question. Your 40 acres, not the entire acreage you own, will be compulsory pooled so the well can be drilled.
2. "The nonparticipating owner of an unleased mineral interest shall be considered to be subject to a 1/8 royalty interest which shall be free of any withholding for payment of any costs of drilling, completing, equipping, or operating costs, including postproduction costs".<sup>1</sup>
3. It will be a non-development order. It will not establish any right for the operator to operate on your surface lands to place a well site, tanks, roads, etc.
4. You will receive no lease bonus because there will be no lease signed.

Compulsory pooling, depending on your goals and objectives, is an option that some landowners have indicated works well for them. They receive a royalty based on gross income, not net income, they do not have to be obligated to a lease and there are no development or surface activities on their land because all of the mineral harvesting is occurring underground by means of directional or horizontal wells.

The Department of Environmental Quality documents "Pooling of Properties for Oil and Gas Production" and "Mineral Rights" are good information sources for pooling, including compulsory pooling.

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Reviewed by: Sue Maul, Department of Environmental Quality

Categories: Beef, Dairy, Farm Management, Field crops, Fruit, Nursery and Christmas trees, Pork, Vegetables

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<sup>1</sup> Order of the Supervisor of Wells (A) 16-12-03, February 9, 2004

## **OIL AND GAS LEASING WEBINAR AND DVD**

Curtis Talley Jr., Farm Management Educator

Just a reminder that we have an oil and gas leasing webinar (narrated slide presentation) that discusses what landowners need to know about oil and gas leasing at [www.msue.msu.edu/oilandgas](http://www.msue.msu.edu/oilandgas). It is titled “New MSU Extension Oil and Gas Leasing Video.”

The same presentation is also available as a DVD. The DVD can be ordered and sent to you by calling Oceana County Michigan State University Extension at 231-873-2129. You can also order the DVD by e-mailing [vanberg2@anr.msu.edu](mailto:vanberg2@anr.msu.edu). There is a \$10 charge for shipping and handling. See the March issue of the Oil and Gas Newsletter for more details about the content of this webinar.

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### **Landowner Informational Meetings**

We hope to have a meeting in Lapeer County either July 9 or July 11. As details become available we will send them to you.

MSU Extension personnel, private attorneys specializing in assisting landowners with oil and gas leasing and personnel from the Department of Environmental Quality continue to be willing to offer public meetings to educate landowners about the oil and gas industry in Michigan, which includes understanding and negotiating oil and gas leases. If you would like a meeting, please contact the editor.