MEMORANDUM

To: Louisiana State Mineral and Energy Board
Office of Mineral Resources (c/o Suzanne Hyatt at suzanna.hyatt@la.gov)

From: C. Peck Hayne Jr. and Cynthia A. Nicholson
Gordon, Arata, Montgomery, Barnett, McCollam, Duplantis & Eagan, LLC

Date: May 1, 2019

Re: May 2019 Mineral Board meeting regarding proposed Louisiana State Lease form

In connection with the Board's upcoming special meeting on Tuesday, May 7, 2019 and its monthly meeting on Wednesday, May 8, 2019, we submit these comments to Articles 3, 4, 6, 7, 8, 11, 12, 13, 14, 15, and 19 of the proposed new lease form.

Although oil production for the nation more than doubled over the past decade (with U.S. crude oil production in 2018 surpassing the previous record in 1970) and national gas production has increased by about 50%, the sad truth is that oil production in Louisiana—along with related revenues to the State—has fallen dramatically (with gas production in Louisiana barely holding steady). Reports from the federal Energy Information Administration (EIA) and the DNR's SONRIS reflect the following production volumes over the past decade:[1]

	in the United States		in Louisiana	
Year	**Oil (in MMBbl)**	**Gas (in Bcf)**	**Oil (in MMBbl)**	**Gas (in Bcf)**
2009	1,952	20,624	69	1,528
2010	1,999	21,316	68	2,175
2011	2,064	22,902	69	2,982
2012	2,380	24,033	71	2,964
2013	2,725	24,206	72	2,323
2014	3,197	25,890	70	2,027
2015	3,442	27,065	65	1,897
2016	3,232	26,592	57	1,775
2017	3,413	27,291	52	2,118
2018	4,001	30,439	49	2,731

[1] For national gas production statistics, see https://www.eia.gov/dnav/ng/hist/n9070us2m.htm; for national oil statistics, see https://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=MCRFPUS1&f=M. For state statistics, see the DNR's SONRIS website under the heading Yearly Production by Parish.

Thus, it is critical that the new lease form not become a further impediment and deterrent to oil and gas production in the State. Accordingly, we urge the Board to be mindful of the dangers in adding incremental burdens to the new lease form, and at all times to pose the question whether a particular lease provision will ultimately help or hurt our State over time.

Below, we turn to the nine individual articles under consideration.

Article 3 (entitled Lease Maintenance) was addressed at prior Board meetings. We incorporate our previously submitted comments (both written and oral). As to the termination of deep rights, we recommend that proposed Article 3(E)(1) be revised to read as follows:

> (1) Upon written notice to Lessee no sooner than the second Anniversary Date after the end of the Primary Term, Lessor may demand that Lessee release this Lease as to all depths lying more than one hundred feet (100') below the stratigraphic equivalent of the deepest depth drilled on the Leased Premises or any lands pooled or unitized with any portion thereof (the "***Deep Rights Acreage***"). Lessee shall have one (1) year thereafter (as the Lessor may extend in its discretion) to develop the Deep Rights Acreage and, unless Lessor withdraws its demand, shall execute, record and deliver to Lessor within thirty (30) days after such one-year period (as may be extended) a release of the Deep Rights Acreage (as determined as of the date of such release).

Article 4 (entitled Transfers and Assignments) is derived from Article 8 of the current lease form. We recommend three changes to this proposed article.

1. Subsection (c) of La. R.S. 30:128 specifies various transfers for which Mineral Board is not required:

> (c) A transfer for purposes of this Section shall not be deemed to occur by the granting of a mortgage in, collateral assignment of production from, or other security interest in a mineral lease or sublease or the transfer of an overriding royalty interest, production payment, net profits interest, or similar interest in a mineral lease or sublease.

To avoid any doubt whether the lease form incorporates this same carve-out, we recommend that the following sentence be added to the end of Article 4(a):

> Nonetheless, an Assignment shall not include, and the prior sentence shall not apply to, the granting of a mortgage in, collateral assignment of production from, or other security interest in this Lease or the transfer of an overriding royalty interest, production payment, net profits interest, or similar interest in this Lease.

2. Under current Louisiana law, an original lessee remains solidarily liable to its lessor after an assignment, unless the lessor expressly agrees otherwise. But following this default law here would discourage mineral development in Louisiana. To avoid the risks from solidary liability with a third-party assignee, many lessees (particularly larger companies) have (and, if the language as currently proposed for Article 4(B) is adopted, will continue to) let their leases lapse rather than be assigned to a third-party assignee for further development and production—and revenues to the State. ***We have heard from numerous companies and brokers that this is a MAJOR CONCERN.*** Notably, the largest mineral lessor in the country (the federal government) has long taken a more practical, economically-promoting approach: for example, under 30 C.F.R. §§ 250.1701-1702 and 556.710, an assignor of record title interest in a lease under the federal Outer Continental Shelf Lands Act (OCSLA) remains liable for those obligations that already accrued ***before*** its assignment is approved by the BOEM (the pertinent federal agency that must approve assignments of OCS leases) but is not liable for decommissioning (P&A) obligations for wells drilled ***after*** the assignment is approved. We strongly urge the Board to include a similar provision in the proposed lease form. To this end, we urge that proposed Article 4(B) be revised to read as follows:

> (B) Notwithstanding Lessor's approval of an Assignment and regardless of any understanding, agreement, language or reference to the contrary in an Assignment, an Assignment does not release or relieve the assignor, sublessor or transferor from satisfying and complying with its obligations accrued before Lessor's approval of the Assignment. But an assignor or transferor under an Assignment shall not be responsible for any liabilities

> or obligations accruing under this Lease thereafter (including without limitation for payment of any royalties with respect to any production thereafter, for maintaining insurance or financial security thereafter or for Restoration Obligations with respect to any well or other facilities installed thereafter).

3. Under Mineral Code article 128, an assignee becomes directly responsible to the lessor for obligations ***only*** "[t]o the extent of the interest acquired":

> To the extent of the interest acquired, an assignee or sublessee acquires the rights and powers of the lessee and becomes responsible directly to the original lessor for performance of the lessee's obligations.

Thus, we urge that proposed Article 4(C) be revised similarly to read as follows:

> (C) To the extent of the interest acquired, an assignee, sublessee or transferee under an Assignment shall acquire the rights and powers of Lessee and become responsible directly to Lessor for performance of Lessee's obligations.

Article 6 (entitled Units) combines Articles 9, 10, and 14 of the current lease form (all relating to rights and duties when all or a part of the Leased Premises is within a unit) into a single article with some changes. The second sentence of proposed Article 6(B) would impose a deadline for the lessee to provide certain unit application information, but this sentence does not properly address the circumstance when a third party (and the lessee) is the applicant for the proposed unit; in such circumstances, the lessee will often have no idea that any unit is being proposed. We recommend that this sentence be revised to read as follows:

> If Lessee is the applicant, these copies shall be furnished to Lessor at the earlier of the time the application or notice is filed with the Commissioner of Conservation or the time required by the applicable orders or regulations of the Commissioner of Conservation for furnishing such information; if Lessee is not the applicant, copies shall be furnished to Lessor promptly after Lessee receives copies of such application or notice.

The last sentence of Article 10 of the current lease form has no time deadline for submitting unit plats for units created by the Commissioner of Conservation. Under proposed Article 6(B) of the

new form, a lessee would be required to submit such unit plats within 90 days of initial production (but can request an extension of this deadline). But if the lessee is not the unit applicant, it may have no access to such unit plats or know when they are submitted to the Office of Conservation. Further, the proposed deadline does not consider that a well may begin production before it is unitized. We recommend that this proposed sentence in Article 6(B) be revised to read as follows:

> For a Unit that is created by an order of the Commissioner of Conservation and includes all or a portion of the Leased Premises, Lessee shall furnish Lessor a survey plat for the Unit on or before ninety (90) days after the last of (i) initial production from any unit well for the Unit, (ii) the effective date of such order or (iii) the date when Lessee receives a copy of such survey plat.

Proposed Article 6(C) could be construed to require the Lessee to pay royalties for production ***before*** the Lease's effective date and also to require to require the Lessee to pay royalties to the State for ***all*** unit production, even if a portion of the unit is outside the Leased Premises; further, if the lessee is not the unit operator, it may not have timely access to production information for the unit. We recommend that Article 6(C) be revised to read as follows:

> (C) For any production attributable to a Unit (and regardless whether any development and operating costs chargeable to the Leased Premises have been paid), the royalty required under this Lease and attributable to the portion of the Unit within the Leased Premises shall be paid within 90 days after the last of (i) the initial production from such Unit, (ii) the Effective Date of this Lease or (iii) the date when Lessee obtains reliable evidence of the volumes of such production.

Article 7 (entitled Protection Against Drainage) was addressed at prior Board meetings. We incorporate our previously submitted comments (both written and oral). We recommend that proposed Article 7 be revised to read as follows:

> (A) Lessee agrees to protect the Leased Premises from drainage of oil, gas or other liquid or gaseous minerals by a well completed after the Effective Date and producing from lands not owned by Lessor and not included in a Unit containing all or a portion of the Leased Premises (such well, an

"***Adjacent Well***"; and such drainage, "***Drainage***"). It shall be presumed, subject to rebuttal by Lessee, that Drainage is occurring if the Adjacent Well is producing within six hundred sixty feet (660') of the Leased Premises. This presumption shall not serve to limit or preclude Lessee's obligation to protect the Leased Premises from Drainage in cases where the facts giving rise to the presumption do not exist.

(B) Lessee's obligation to protect against Drainage from an Adjacent Well shall be satisfied if (i) Lessee (within the time period specified in Articles 7(C) and 7(D) below) begins Actual Drilling Operations for a well drilled to a depth necessary to protect the Leased Premises from such Drainage (***"Offset Well"***) or (ii) a reasonably prudent operator would not drill such an Offset Well.

(C) Subject to Article 7(D) below, the time period for Lessee to satisfy its obligations under Article 7(B)(i) above shall be within one hundred twenty (120) days (as that time period may extended by Lessor) after (i) the completion date for the Adjacent Well if Lessee is the operator of the Adjacent Well or (ii) receipt of written notice from Lessor if Lessee is not the operator of the Adjacent Well.

(D) Lessee may delay the drilling of an Offset Well for a period not to exceed one (1) year by making payments to Lessor in the same manner and amount equal to one-half (1/2) the royalties Lessee would have to pay pursuant to this Lease if the production being obtained from the Adjacent Well had instead been obtained from a well producing from the Leased Premises (***"Offset Royalties"***); provided, however, that if Lessee is not the operator of the Adjacent Well, payment for such Offset Royalties shall be (i) not due before thirty (30) days after Lessee receives reliable evidence of the production volumes from the Adjacent Well and (ii) based on the price that Lessee is then receiving for production attributable to the Leased Premises. Offset Royalties are intended to permit Lessee time to further evaluate the producing Adjacent Well, and the payment of Offset Royalties shall not of itself serve to maintain this Lease if this Lease is not otherwise being maintained.

(E) Lessee may also satisfy its obligation to protect against Drainage from an Adjacent Well by (i) delivering to Lessee a release of that portion of the Leased Premises subject to Drainage from such Adjacent Well or (ii) initiating unitization proceedings to include all or a portion of the Leased Premises within a Unit as to which the Adjacent Well would be a unit well. Any damages from Drainage occurring before the date such a release is executed or such unitization proceedings are commenced but after the time period specified in Articles 7(C) and 7(D) above shall be owed by Lessee to Lessor.

Article 8 (entitled Lessee Reporting) revises Article 11 of the current lease form. Article 8(A) would require the lessee to provides to the lessor a list of data "reasonably available to Lessee." A lessee should not have to provide data in a format different from the actual format in its records. We urge that the beginning of the first sentence of this proposed Article 8(A) be revised to read as follows:

> (A) Lessee shall furnish Lessor, upon request, well and survey data (in the form actually maintained by Lessee if in Lessee's possession or as reasonably available to Lessee if not in Lessee's possession) ...

Article 11 (entitled Lease Access) revise Articles 11 and 19 of the current lease form. Proposed Article 11(A) requires the lessee to "maintain and preserve the public's access to public waterways throughout the State lands covered by this Lease." To avoid any doubt that a lessee has no duty to ***create or increase*** public access beyond what actually existed before the lease was granted and also to avoid any possible argument that the mere placing of any well or other facility in navigable waters would be a breach of an obligation to "maintain and preserve" public access, we urge that Article 11(A) be revised to read as follow.

> (A) Lessee shall not unreasonably limit and restrict the public's access to public waterways across the Leased Premises (provided that the placing and maintaining of wells and other facilities on the Leased Premises shall not be deemed a breach of this provision).

Article 12 (entitled Lessor's Rights) is new. We have no comments on this provision.

Article 13 (entitled Surface Use and Restoration) revises Article 24 of the current lease form. We recommend several changes to this proposed article.

First, in proposed Article 13(A)(2), the phrase "with the highest degree of care using standard industry practices and procedures" both is inherently conflicting and also is not a

commonly used standard (and thus is not a phrase that courts have well defined). We suggest that this phrase be revised to read "using standard industry practices and procedures" instead; that phrase is commonly used in the industry and well defined by courts.

Second, proposed Article 13(A)(2) would impose a most-likely impossible burden on lessees. The second sentence would require a lessee to recapture "***all*** escaped hydrocarbons or other pollutants." For any gaseous substances that might escape into the air, recapture of even a small fraction of such substances would likely be impossible. Although recapture should generally be much more feasible for liquid substances, a complete recapture of ***all*** escaped liquid substances would likely also be impossible. Further, the recapture of certain escaped substances may sometimes cause more harm to the environment than the escaped substance itself might ever cause if not recaptured. We recommend that this proposed second sentence be deleted in its entirety; the next sentence already separately protects the State from any damages to the Leased Premises caused by such escaped substances. Solely in the event that the Board keeps in the lease form some comparable provision, we recommend that this second sentence be revised to read as follows:

> Lessee shall comply with all applicable statutes, rules and regulations for the recapture of any hydrocarbon minerals or other pollutants escaped from any well drilled under this Lease on the Leased Premises.

or alternatively to read as follows:

> Lessee shall use reasonable means at its disposal to seek to recapture (where commercially available and reasonable) any hydrocarbon minerals or other pollutants escaped from any well drilled under this Lease on the Leased Premises (provided, however, that Lessee need not do so if it determines that such recapture would likely cause more harm to the environment that would not recapturing such escaped substances).

Third, proposed Article 13(A)(3) seeks to impose a time limit for removing materials and equipment "no longer necessary for exploration or production." But the question when materials

or equipment may no longer be necessary for exploration or production" could often be a very subjective determination if the time period is ***before*** termination of the lease as to the portion of the Leased Premises on which such materials or equipment are located. Further, the proposed 60-day time limit here will often be difficult (if not impossible) to meet (as it evidenced by the one-year period provided in Article 13(B)(1) for Restoration Obligations); regulatory permits to undertake such operations frequently take months to obtain. Further, the obligation to remove such materials and equipment is already covered in Article 13(B)(1). Thus, we urge that Article 13(A)(3) be deleted entirely from the proposed lease form.

Fourth, proposed Article 13(A)(4) would require the lessee to report certain incidents to the Lessor. This is another requirement that simply imposes an additional administrative burden on a lessee without any comparable benefit to the State. This proposed language would apply only to discharges that are already "reportable ... as required by applicable state and federal environmental and conservation statutes and regulations"; in other words, this provisions would apply only to discharges that a lessee is otherwise already required to report to government agencies. Because the OMR does not itself manage or regulate discharges (that's the province of, say, the DEQ and the Office of Conservation), it is difficult to see what purpose is to be achieved by requiring a lessee to report a discharge not only to the governmental authorities required by law, but also to the OMR. We recommend that proposed Article 13(A)(4) be deleted entirely from the proposed lease form. But solely in the event that the Board determine that some language should be included in the lease form, we recommend that the proposed language (which currently is awkwardly worded) be revised to read as follows:

> (4) If Lessee is required by any applicable state or federal environmental or conservation statute or regulation to report to any governmental authority (or other entity) any discharge on the Leased Premises, Lessee shall also report such discharge to Lessor.

Fifth, proposed Article 13(A)(5) is worded too far-broadly. As currently worded, it could perhaps be construed to require a lessee to maintain and restore the entire Leased Premises, including any portion that the lessee has never touched. Further, the language for the lessee to keep the Leased Premises (as opposed to improvements thereon) "in good order and repair" does not make sense. Further, as currently worded, the sentence is difficult to parse and understand. We recommend that proposed Article 13(A)(5) be revised to read as follows:

> (5) All improvements (and related facilities) utilized, owned, placed and/or caused to be placed on the Leased Premises by Lessee shall, so long as they remain on the Leased Premised, be maintained by Lessee, at its sole cost and expense, in accordance with any applicable state or federal law and otherwise in good order and repair and in the appropriate condition for the safe conduct of any activities conducted on the Leased Premises pursuant to the rights granted under this Lease.

Sixth, proposed Article 13(B)(1) addresses Restoration Obligations. The proposed language would require the lessee to restore the Leased Premises to its original condition as of the Effective Date of the lease, even if the land was altered thereafter by causes having nothing to do with the lessee's activities (such as by a hurricane or by human activity unrelated to the lessee). We recommend that the phrase "to restore the Leased Premises, as near as practicable, to the condition existing on the Effective Date of this Lease" in the first sentence of Article 13(B)(1) be revised to read as follows instead:

> ... to restore the Leased Premises, as near as practicable, to the condition existing on the Effective Date of this Lease (as it may have been altered thereafter by natural causes or other causes unrelated to Lessee's activities under this Lease) ("***Restoration Obligations***") ...

Seventh, proposed Article 13(B)(1) also imposes a one-year time period for conducting Restoration Obligations. But as also discussed in item "*Fourth*" above, the concept of when, before lease termination, a well, structure or facility may no longer be used or useful for operations or productions is problematic. Also, if a flowline or similar structure runs across a

released or expired portion of the Leased Premises but is still used for another portion, the lessee should be allowed to continuing using that flowline or structure. We suggest that the second sentence of proposed Article 13(B)(1) be revised to read as follows:

> Lessee shall complete the Restoration Obligations for any well, structure or other facility within one (1) year after the date this Lease is expired, terminated or released (whichever occurs first) as to the portion of the Leased Premises where such well, structure or facility is located; provided, however, that, if any pipeline or other structure or facility is located on a released/terminated portion of the Leased Premises but is still used or useful for a portion of the Leased Premises still covered by this Lease, then the Restoration Obligation with respect to such pipeline or other structure or facility shall be completed within one (1) year after this Lease is expired, terminated or released as to such other portion of the Lease Premises.

Eighth, proposed Article 13(B)(2) would prohibit a lessee from salvaging or removing any equipment, structures or facilities until after the wells for which same were used have been P&A'd. This requirement is problematic for several reasons. Particularly for facilities in waterbottoms, it may not be physically possible to P&A the pertinent well until structures and facilities on top of the wellbore have first been removed. Also, lessees frequently use equipment (particularly equipment relating to initial drilling operations) at multiple locations; this absolute language could be construed from prohibiting a lessee from removing any or all equipment in the ordinary course of business, until all wells have been P&A'd. Moreover, this proposed language could be construed as prohibiting a lessee from ***replacing*** equipment or facilities during the life of the lease. We recommend that the proposed second sentence in Article 13(B)(2) be deleted in its entirety.

Article 14 (entitled Financial Security) is new. This proposed provision is duplicative of existing law and thus merely adds unnecessary administrative burdens on lessees: all it would do is require that the lessee comply with the Office of Conservation's requirements for financial

security. But the law already imposes that obligation. Thus, we recommend that this proposed Article 14 be deleted entirely from the proposed lease form. Solely in the event that the Board believes it to appropriate for the lease form to have some provision on financial security, we recommend that the entire Article 14 be revised to read as follows:

> Upon request, Lessee shall furnish to Lessor evidence of the financial security required under the applicable statutes, rules and regulations of the Louisiana Office of Conservation for any well drilled on the Leased Premises.

Article 15 (entitled General Liability Insurance) is new. We have several comments on these new provisions.

First, proposed Article 15(A) would leave open-ended the amount of insurance required. Although it specifies combined limits of $3 million per occurrence, it goes on to provide that the Board may, upon notice, impose "other" limits instead. A contractual ability for the Board to change the required insurance limits would generate uncertainty as to a lessee's obligations and thus make State leases much less attractive. We recommend that the parenthetical phrase be deleted from the first sentence of proposed Article 15(A).

Second, proposed Article 15(A) would require a lessee to provide evidence of its insurance coverage at least 30 days before any development activities are begun under the lease. We suggest that the deadline for providing such insurance evidence simply be before the commencement of such activities. Thus, we recommend that the phrase "shall commence thirty (30) days prior to any surface activities" in the last sentence of proposed Article 15(A) be revised to read "shall commence upon any surface activities" instead.

Third, proposed Article 15(D) would require that any required insurance be provided by a company authorized to do business in Louisiana and with an A.M. Best's rating of at least A-:VI. We foresee two issues with these requirement: first, some oil companies operating in Louisiana

are insured by companies that are not authorized (or required to be authorized) to do business in Louisiana; and second, many commonly-used insurers (such as, for example, insurance syndicates at Lloyd's of London) do not have an A.M. Best's rating. Thus, if the Board decides to keep Article 15(D) in some form, we recommend that Article 15(D) be revised to read as follows:

> (D) Unless Lessor agrees otherwise, the insurance coverage required hereby of Lessee shall be provided by a company authorized to do business in the State of Louisiana having an A.M. Best's rating of A-:VI or higher (or a comparable rating by another rating agency acceptable to Lessor). If any insurer issuing any such policy does not meet the requirements of the prior sentence, Lessee shall obtain one or more substitute policies from one or more insurers that meeting such requirements.

Fourth, the last sentence of proposed Article 15(E) suggests that the lessor can require that a lessee's insurance policy contain endorsements not specified in the lease form itself. Again, a contractual ability of the State to require additional insurance endorsements would generate uncertainty as to a lessee's obligations and thus make State leases much less attractive. We recommend that that phrase "along with any additional endorsements that may be requested by Lessor" be deleted from the last sentence of proposed Article 15(E).

Article 19 (entitled Indemnity and Hold Harmless) is derived from Article 15 of the current lease form. We suggest that the first and second sentences can be combined to read easier. We recommend that the proposed second sentence of Article 19 be deleted in its entirety and that the phrase "the State, the Department of Natural Resources, the Board and OMR" in the first sentence of Article 19 be revised to read "the State, the Department of Natural Resources, the Board, the OMR and the officers, employees, agents and representatives of Lessor" instead.

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