GORDON ARATA MONTGOMERY BARNETT

MEMORANDUM

TO: Louisiana State Mineral and Energy Board

FROM: Cynthia Nicholson (cnicholson@gamb.law)
Peck Hayne (phayne@gamb.law)

DATE: April 3, 2019

RE: State's revised draft of Articles 3 and 7 and related definitions in the 2019 proposed new State of Louisiana Lease form

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In response to the email from OMR Staff member Suzanne Hyatt this past Friday afternoon, March 29, 2019 relating to proposed revisions to Articles 3 and 7 (and the definitions of "Good Faith" and "Unitized Operations") of the proposed new State of Louisiana Lease form, we submit these comments.

Definitions. We have no comments to the revised definition of "Good Faith." We suggest a few, further clarifying changes to the definition of "Unitized Operations" (at lines 7-16 of page 4 of the 3/29/2019 redlined draft):

> (J) ***"Unitized Operations"*** shall mean Actual Drilling Operations, Actual Reworking Operations, Production in Paying Quantities, Acceptable Lease Operations and/or Shut-in Payments attributed to one or more wells, whether located on the Leased Premises or on lands pooled or unitized therewith, designated or otherwise constituting unit wells, cross unit wells, substitute unit wells and/or alternate unit wells in one or more Units encompassing all or a portion of the Leased Premises. For purposes of Unitized Operations, the definitions for the defined terms Actual Drilling Operations, Actual Reworking Operations, Production in Paying Quantities, Acceptable Lease Operations and~~/or~~ Shut-in Payments~~,~~ are expanded to include operations, production or payments attributed to **unit** wells whether located on the Leased Premises or on lands pooled or unitized ~~there~~with **any portion thereof**.

Article 3 (entitled Lease Maintenance) of the proposed form addresses lease maintenance during and after the primary term, deferred development, shut in well payments and termination of deep rights.

While the changes to the definition of Unitized Operations are appropriate for instances where that term is used, the term is not used, for example, in Articles 3(A)-(B). Thus, this revision is not adequate where the term Actual Drilling Operations, Actual Reworking Operations, Production in Paying Quantities, Acceptable Lease Operations and Shut-in Payments are used in the lease; those terms still need to reference not just the Leased Premises but also lands pooled or unitized with any portion thereof. To this end, we endorse Tommy Smart's similar comments in this regard. We refer you to the innumerable private leases that reference these concepts (and similar terms) with respect to both the leased premises and lands pooled or unitized with any portions thereof.

Article 3(E) (on pages 6-7 of the 3/29/2019 draft) addresses release of deep rights. These deep rights are still defined with respect to "true vertical depths" to be "uniform, constant and unvarying" (rather than with respect to stratigraphic equivalent depths or, where the pertinent depth within a pertinent well bore is within a unit established by the Commissioner of Conservation, with respect to the base of the unitized formation as defined by the Commission). We believe that these references to "true vertical depths" are inappropriate and will create more confusion than they would resolve and ultimately will make the state lands at issue less marketable.

References to "true vertical depths" that are "uniform, constant and unvarying" ignore the fact that the formations under the earth are anything but "uniform, constant and unvarying." Indeed, in portions of south Louisiana, where faulting or surrounding salt domes can create extreme geologic formations that are anything but flat. Thus, for example, in defining unitized formations, the Commissioner of Conservation never defines the top or bottom of a unitized

formation with reference to a single true vertical depth that is "uniform, constant and unvarying" throughout the geographic extent of the unitized formation; instead, the Commissioner defines these top and bottom depths by references the stratigraphic equivalent of identifiable depths in specified wellbores. There rarely are material disputes on the issue of where a particular base of a unitized formation lies elsewhere in a unit; however, in the few instances where such a dispute may arise and in fact be material, the Commissioner is fully capable to resolve such dispute—even if different parties may find different experts to express different opinions on the issue. Among other things, a release tied to a single "true vertical depth" could require a lease to release a portion of a currently producing zone.

First, we propose that the release take into consideration the definition of any unitized zone adopted by the Commissioner of Conservation for unitized lands. Furthermore, we believe that using true vertical depth as the measurement is also inappropriate. We suggest that termination should instead be the specified number of feet (we would suggest 300 feet) below the stratigraphic equivalent of the deepest depth drilled on the Leased Premises or on any lands pooled or unitized with any portion thereof. Lessees are entitled to retain all depths drilled including the entirety of the zones or reservoirs discovered. South Louisiana geological is very different from that in Northern Louisiana and the requirement that the deep rights being released have a constant depth is particularly inappropriate in the southern portion of the state.

The draft language states the "Lessor may terminate". We think a lessee should have a "cure" opportunity after a release demand is made by the Lessor. We again suggest that a reference be made that any such termination would be subject to rules and regulations promulgated by the Board, such that the Board could provide for a process similar to development demands, where a lessee would receive notice and have the opportunity to present its development plans within a

specified period thereafter. Also, rather than setting a period of two years, we suggest that this period be left blank, similar to the primary term and allow lessees to include that term in their bid.

Article 7 (entitled Protection Against Drainage) contains several changes from article 5 of the current lease form. As now revised, any productive well not already unitized with a portion of the Leased Premises triggers this provision. Further in the current lease form, the lessee's obligation to drill this well is not triggered until it receives a notice from the Board if it is not the operator or working interest owner of the adjacent well, but the revised proposal has no corresponding notice requirement for triggering this obligation. We again urge the Board to include a notice provision, as a lessee with no interest in this other well could easily breach this obligation as it may not be aware of this adjacent producing well.

As in the current lease form, Offset Royalties are based upon actual production of the Adjacent Well; however, the provisions in the current lease form for a lessee who cannot timely obtain such production information have been deleted and failure to timely pay these payments will result in a breach of the lease. We again urge the Board to reconsider this suggested change.

The proposed lease form contains a presumption of drainage and it now provides that a Lessee can avoid application of this article if it proves that drilling this well would not be economical. This should be revised to include proof that drainage is not occurring or if the lands alleged to being drained are released or if the Commissioner creates a unit for that well (whether such unit includes or does not include any portion of the Leased Premises) or determines that such other well does not drain a formation that includes any portion of the Leased Premises.

The revised draft provides that the obligations under this lease will be satisfied if a unit is created but only from the date of the unit's creation. We disagree with this provision; this should instead provide that a lessee satisfies this provision by applying for a unit. If the commissioner

determines that a unit should not be formed for this well or a unit is formed but the commissioner does not include any leased lands, then there should be no further obligations.

Also this provision should not apply to an Adjacent Well already drilled prior to the granting of this lease.

Also the last sentence of this provision should be revised as to when "damages" may be owed. If the Commissioner creates a unit for this well and it includes any portion of the Leased Premises and the well commenced production after this lease was granted but before the unit's effective date, then and only then should any compensatory payments be due to the state. This payment should be limited to an amount equal to this lease's share (based upon the unitization) of the actual production during such period.

Further, as noted during the discussion during the March meeting, the 90 and 120 days provisions to drill a well are inappropriate—particularly with regard to South Louisiana. For example, where a wetlands permit is required, a lessee shall not be able to comply with these provisions within such time periods.

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