



MEMORANDUM

TO: Members of the Oil and Gas Industry

FROM: Cynthia A. Nicholson, Peck Hayne and Tommy Smart

DATE: February 8, 2019

RE: 2019 proposed new State of Louisiana Lease form

At their January meeting, Louisiana's State Mineral and Energy Board discussed a new proposed lease form, which is attached. Also here is a link to the form from the DNR's website:

http://www.dnr.louisiana.gov/assets/OMR/media/forms_pubs/PROPOSED_NEW_LEASE_FORM_2019_DRAFT_1-9-19.pdf

This lease form was prepared by the OMR staff without the input of industry.

The staff will present this lease to the Board for its review and approval over the next year. It has been announced that Articles 1, 2, 3, 5, 7 and 17 of the proposed lease form will be presented at the Board's February 13th meeting. We will continue to monitor this and send out updates. Should you have any questions, please do not hesitate to contact us.

Article 1 (entitled Bonus) addresses payment of the bonus and first year's rental. The proposed form makes no substantive change to Article 1 of the current lease form.

Article 2 (entitled Primary Term) addresses the primary term of the lease and contains new concepts. The current lease form allows the Board to grant a two-year extension of the primary term under certain circumstances solely for secondary or tertiary recovery projects or ultra-deep wells. On the one hand, the proposed form provides for extensions of up to two years for *any* lease (not just ones involving recovery projects or ultra-deep wells) with the Board's prior approval. On the other hand, unlike the current form, the draft provides that this extension shall be on the same terms of the lease, "except for any additional consideration and/or modified terms accepted by the Board for the granting of said extension." It appears that these "new" terms would not be included in the original lease bid, but instead would be negotiated with the Board at the time of the extension request.

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 and would change articles 3-4, 6(d) and 23 of the current lease form in several respects.

During the primary term, a lease shall terminate on an anniversary date unless rentals are paid, Actual Drilling Operations are occurring or Production in Paying Quantities is occurring. Actual Drilling Operations are still limited to drilling a new well, or the deepening, sidetrack, plugging back of attempted recompletion in a separate interval in an existing well.

At the end of the primary term and thereafter, the lease can be maintained by Acceptable Lease Operations (which include Actual Drilling Operations and Actual Reworking Operations) or Production in Paying Quantities. [These new definitions provide that such operations be "conducted on the Leased Premises"; we would prefer that this definitional phrase be changed throughout to read "conducted on the Leased Premises or on any Unit that includes any portion of the Leased Premises" instead. Additionally, a definition for "Good Faith" has been added,

which then is included/used under the defined terms Acceptable Lease Operations, Actual Drilling Operations and Actual Reworking Operations. “(2)” under the Good Faith definition appears to require that a certain depth to be reached. This requirement may have been borrowed from the requirements for interrupting prescription for a mineral servitude; however, in our opinion it is too stringent a requirement for purposes of lease maintenance. There are often situations where a lessee is conducting operations and may not be able to get to a chosen depth.]

The deferred development provision in article 3(C) of the proposed form is similar to the one in article 23 of the current lease form.

Under the proposed form, the lessee cannot maintain a lease by shut-in payments unless the lessor has previously approved the request. A maximum of six consecutive six-month shut-in periods are allowed; however, prior consent from the lessor is required for each shut-in period. This approach is more burdensome than the current lease form and most other lease forms—normally if the well meets the shut-in requirements, the rental is paid and the lease is maintained. Approval/consent each time is not normally required. The approval/consent requirements introduce uncertainty as to whether a lease may be maintained in this manner and will likely create timing issues given the need for Board approval for each shut-in period.

For the first time, a depth termination provision is being proposed. Under this provision, the lessor may elect to terminate the lease two years after the primary term as to all deep rights, defined to be a specified number of feet “below the deepest producing perforation.” The release is to be of all depths below the true vertical depth of this perforation. We believe that using the perforation to define the bottom of the productive zone is inappropriate and unreasonable. Under this proposed provision, the lessor could require a lessee to release a portion of a currently producing zone. Furthermore, we believe that using true vertical depth as the measurement is also inappropriate. We suggest that, if a depth-termination provision is retained, termination be

the specified number of feet below the stratigraphic equivalent of the base of the formation for the deepest producing perforation.” The draft language states the “Lessor may terminate”. We 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. 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.

The proposed form also makes changes on the method of payment of rentals. The current lease permits payment by check or draft; under the proposed draft, the rental must be paid in a form acceptable to the Board. To make it clear that a check or draft is always acceptable, we would prefer for this change to provided that the rental be paid by “check, draft or other form acceptable to the Board.” Also, while the current lease form indicates that payment is timely if send by *registered* mail on or before the rental due date, the proposed form authorizes any form of mailing (thus including certified or first-class mail) on or before the Anniversary Date.

Article 5 (entitled Force Majeure and Suspending Events) concerns force majeure and suspending events, which includes such things as lack of availability, and changes article 13 of the current lease form. Under the proposed form, initial notice must be given to OMR within 90 days after the triggering event and also 30 days thereafter while such event is continuing. Under the proposed form, the lessor also reserves the right in its sole, reasonable discretion to determine that a lessee was not entitled to assert force majeure or a suspending event.

Article 7 (entitled Protection Against Drainage) contains several changes from article 5 of the current lease form. First, there is no longer a minimum productive time period for an adjacent well to trigger an obligation to drill on wells: under the current lease form, the obligations under this provision are triggered only if a minimum productive status is satisfied,

but the obligations under the proposed form are triggered by any “producing” well. 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 proposed form has no corresponding notice requirement for triggering this obligation. Thus a lessee with no interest in this other well could easily breach this obligation if it is not 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. Also, the current lease form provides for the compensatory payments to be made based upon one-half (1/2) of the production from the well in question; whereas the proposed language appears to be based upon the full production from such well.

Under the current lease form, the lessee owes no other offset obligations if a unit for this adjacent well including all or part of the leased premises is created before the maturity date which is at least 120 days after production commences or a longer time period if notices are to be given to lessees with no interest in said adjoining well. However, under the proposed form, even if a unit for such well is timely formed, the lessee still owes damages to the lessor for production occurring before the date of the unit. This payment obligation apparently is applicable even if the state lease in question became effective after the adjacent well commenced production.

Article 17 (entitled Termination and Release) corresponds to article 7 of the current lease form. A lessee’s partial release does not reduce the amount of rentals required to maintain the lease during the primary term.

A lessee must pay \$100/day if, within 90 days after the termination of any or all portions of the lease, the lessee does not provide OMR with certified copies of a recorded release instrument. Within this same 90-day period, the lessee must submit to OMR (i) a listing of all unplugged wells and facilities placed by lessee on the released acreage and (ii) a corresponding restoration schedule. While both of these provisions address termination of the lease, it appears that they may also apply if the lease is released, in whole or in part.

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