

Osage Negotiated Rulemaking Committee
Meeting 3 – October 22, 2012
Osage Casino – Tulsa, 951 West 36th Street North, Tulsa, OK 74127
Meeting Summary

Consensus Agreements

The Osage Negotiated Rulemaking Committee reached consensus on the following items during the meeting:

1. The Committee agreed to include draft regulatory language in the meeting summaries with the inclusion of text stating that the text is still in draft form and may change before the final regulations are approved.
2. The Committee agreed to approve the meeting summary from the September Osage Reg-Neg meeting.

Welcome and Opening of the Meeting

The meeting opened with a prayer and introduction of all Committee members and staff who were present. Patrick Field, facilitator, reviewed the agenda for the meeting and invited members of the public interested in making a public comment to sign up to do so.

Members of the Committee, including alternates, and staff to the meeting introduced themselves and provided their organizational affiliations. A full list of Committee members, staff, and members of the public who were in attendance can be found in Appendix A.

Committee members reviewed a draft version of the Meeting Summary from the Committee's September meeting and approved the Meeting Summary. The final, approved version of this document can be found on the BIA's website for this Negotiated Rulemaking at <http://www.bia.gov/osageregneg/>.

Staff to the meeting stated that the Public Repository of documents produced by the Negotiated Rulemaking process would be in place by the end of the week.

Report from Visit to Wind River Indian Reservation

Committee members who visited the Wind River Indian Reservation to learn more about how the Eastern Shoshone and Northern Arapaho tribes manage oil and gas development on their lands.

Committee member Curtis Bear reported that the visit was very productive. By way of providing historical context for production accountability on the Wind River Reservation, Bear noted that the tribes suspected that some of the oil and gas production was not being accounted for during the 1980s and that the systems that the tribes have put in place since then have resolved this issue. He noted that the tribes' share of production revenues was distributed between tribal members and the tribal government, with 85 percent going to tribal members in the form of per-capita payments, and 15 percent going to the government. Bear noted that the tribes emphasize that their young people receive an education and that they encourage them to come back to the reservation and work. Bear stated that the type of staff that the Osage call "gaugers" are titled "inspectors" on the Wind River Reservation. He continued by noting that ONRR also reinforces the inspections that are conducted by the tribes. In terms of drilling obligations, Bear explained that if someone is not drilling, they cancel their lease because business is business. He said that it can take between 6 months and 2 years to approve a drilling lease on the Wind River lands. In addition, they perform oil gauging and gas metering and inspection every six months. Bear explained that he asked tribal representatives if they ever have any trouble accessing any of their property and he reported that the Wind River representatives said that mineral is the dominant estate and that they do not have any trouble with accessing any of their territory. He reported that the Wind River tribes appreciate their working relationship with the Bureau of Land Management. Bear also reported that they feel that they are in charge of managing their mineral estate and like having an all-electronic system as it allows them to access any data that they need at any time. Finally, Bear said that his concern for the Osage is about how working with the Department of the Interior's systems would impact the Osage's right to self-determination, as the tribe's independence is based on the 1906 Act and he is not sure how adopting a system such as the Wind River tribes have would affect that.

Committee member Stephen Manydeeds explained that the visiting group discussed with Wind River representatives what the Wind River tribes' strategy is for oil and gas development. Manydeeds recounted that the Wind River tribes have decided to move away from signing leases and instead are implementing operating agreements. Operating agreements create a tax advantage in comparison to leases. Manydeeds stated that it was nice to see that the Wind River tribes have developed a long-range plan with regards to managing their mineral estate. He reported that the Wind River tribes have placed much of the reporting burden on the operators and that all reporting happens electronically. Manydeeds said that the Wind River

tribes seem to like electronic reporting because it means that there are more people examining the data. He said that Wind River is primarily a gas play. Manydeeds also reported that the Wind River tribes require companies to calibrate leases every three months. If the operator has not calibrated a lease, the tribe moves straight to enforcement action and the operator is immediately fined \$25,000 per day. Manydeeds stated that this sort of enforcement approach is akin to enforcing the speed limit so that operators will comply with their calibration obligations. Manydeeds stated that it takes between 6 months and 2 years to approve a drilling lease on Wind River lands and that the leases are pretty large, in terms of area. He explained that the 1982 Act gave the Wind River tribes tremendous flexibility to design leases to their own benefit. Finally, Manydeeds noted that the Wind River tribes know which operators generally comply with the rules and which ones are not as likely to do so and he opined that having this information makes monitoring and enforcement efforts more efficient because the tribes could focus their energies on the troublesome operators.

Committee members asked a number of questions following up on the visit to the Wind River Reservation. A Committee member asked about what kinds of meters are being used in relation to calibration and Manydeeds reported that various types of meters are in use. In addition to calibrating the meters every three months, the tribes conduct spot-checks. In response to a question about royalty rates, Bear reported that royalty rates are 20 percent. Bear also reported that the Wind River representatives told him that the 1982 Act allowed for royalty rates to vary with the contract and expressed an interest in exploring options under the 1982 Act. In response to a question about lease termination, Bear reported that tribal employees examine electronic reports constantly and if they see any red flags indicating an absence of production, the tribes will quickly cancel the lease. In comparison to the 90-day period of non-production that the Osage allow, the Wind River tribes will cancel a lease after 30 days of non-production. Bear also noted that the Wind River tribes will not hesitate before cancelling leases, whereas the Osage take various factors into consideration before cancelling a lease. Bear stated that the Wind River tribes have a lot of wells operating and a lot of production occurring on their land. An Osage Committee member noted that the majority of daily oil production in Osage County pays 1/8th royalty and asked whether the majority of production in Wind River is similarly subject to 1/8th royalty. Federal Committee members responded that they could not answer definitively, but that likely about half of the production in Wind River is subject to 1/8th royalty and that nationwide on Indian Reservations, the average royalty rate is 16.9 percent. An Osage Committee member responded that the 16.9 percent average rate is comparable to the average rate on Osage lands.

The Committee discussed issues relating to the Osage Tribe's self-determination. A Committee member inquired about the use of the NIOGEMS system by the Wind River tribes. Bear

responded that the tribes seemed to like the system but that he had concerns about self-determination under the 1906 Act. In response to a request to elaborate on these concerns, Bear explained that on the Wind River Reservation, it seemed like the Bureau of Indian Affairs (BIA) was overseeing the tribe's management of their mineral estate and it almost seemed that there was a compact. But, on the other hand, it also seemed that a lot of decisions were made locally, which was good. A federal Committee member noted that the Wind River tribes also have an act of Congress that is unique to them, which is the 1916 Act. This act allows the tribes flexibility to negotiate leases, with a minimum royalty of 1/16th. The federal Committee member explained that the Wind River tribes rarely negotiate leases pursuant to the 1916 Act, and instead mostly use the 1982 Act, but that the earlier act is still on the books and in effect. The official explained that, similarly to the Wind River situation with the 1916 Act, the Osage need not worry about losing their uniqueness under the 1906 Act as it would take an act of Congress to revise the 1906 Act and change authorities and responsibilities.

Committee members discussed issues relating to the Osage Tribe using ONRR's tools and assuming auditing responsibilities. A federal Committee member explained that under the 1982 Act, Native American tribes can apply for the authority to conduct audits under §202. Under §202, a tribe can enter into an agreement with the U.S. Federal Government for three years to have primary responsibility and authority to conduct audits of operators on tribal lands. Under this arrangement, ONRR delegates its authority to conduct audits to the tribe. The tribe is not limited to auditing only that activity which takes place during the three years and can also conduct historical audits during this time period. Under the agreement, the tribe proposes a work plan and budget to the Office of Natural Resource Revenue (ONRR) and the expense of operating the tribal audit office is reimbursed by ONRR. The three-year agreement can be renewed once, and tribes seeking to continue the arrangement must reapply every six years. An Osage Committee member expressed a desire to learn more about the 1982 Act and about §202. The Osage Committee member also asked about hiring authority under §202 and a federal Committee member said that hiring is done by the tribe, although potential employees are subject to undergoing a federal background check. A federal Committee member noted that ONRR does not collect royalties or conduct audits in Osage County, so the §202 model would not apply to the Osage at this time given current ONRR regulations. An Osage Committee member inquired about what procedure would need to be followed in order to allow the Osage to use ONRR's services, since the §202 model would not apply to them, and a federal Committee member responded that a regulatory change would be required. Another federal Committee member added that the current law would not preclude the Osage from using ONRR's tools, and an Osage Committee member noted that this distinction is helpful. Federal Committee members agreed to deliver a presentation about §202 and the potential implications on the 1906 Act of the Osage assuming auditing authority under §202.

The Committee discussed what actions would be required to allow the Osage to conduct auditing and a federal Committee member noted that the Bureau of Indian Affairs (BIA) is responsible for performing the functions that ONRR performs on other tribal lands. He also noted that the Osage are excluded from the Federal Oil and Gas Royalty Management Act (FOGRMA) not by the Act itself, but rather by the regulations accompanying the Act. This federal Committee member further mentioned that it may be possible for the Osage to assume the functions that BIA performs using a contract or compact under §638. Finally, the federal Committee member stated that he would have to explore the options that would allow the Osage to take greater responsibility for overseeing oil and gas production with senior officials at BIA. Another federal Committee member noted that there is a precedent for delegation of auditing authority on the Osage Reservation as he remembered that Superintendent Gordon Jackson delegated auditing authority on a one-time basis to the Minerals Management Service around the year 1995. In response to the suggestions from various federal Committee members, an Osage Committee member and a staff member to the Committee clarified that the Osage are primarily interested in being able to access and use ONRR's tools and are not interested in taking on enforcement authority.

Committee members discussed issues relating to the resources available to the BIA's operations in Osage County and how decisions are made by the Osage Agency. An Osage Committee member stated that the Agency's operations in Pawhuska need to be fixed, in terms of the money and staff people that are available and also in terms of how decisions are made and how quickly decisions are made. The Committee member said that the Agency needs more money and more staff in order to operate effectively. He also said that the Superintendent needs to have sufficient flexibility and authority to make decisions locally, or if decisions cannot be made locally, then the people with decision-making authority need to be much more responsive to developments in Osage County. Another Osage Committee member noted that there used to be two Solicitors on site in Osage County and that not having any Solicitors on site at present creates significant delays. The Committee member stated that making changes in terms of granting enhanced resources and decision-making authority to the Osage Agency should be the first changes that are made and that the Committee could discuss making other changes once these changes are made. A staff member to the Committee representing the interests of the Osage stated that the Osage would like to see the Agency start using ONRR's technology and systems and that the expectation is that, eventually, these tools would be available on-site in Osage County. An Osage Committee member emphasized that the Osage want the Agency to operate efficiently and want the operation on Osage lands to catch up to other operations around the country in terms of the level of sophistication and efficacy. A federal Committee member stated that he understood the Osage's interest clearly and that they could discuss strategies for the Agency to operate more effectively. A federal Committee member noted that

one aspect contributing to the successful estate management on the Wind River Reservation is that the Superintendent there has significant support from federal agencies and that the parties work together as a team there. The federal Committee member suggested that the Osage may want to think about how to create a strong team.

Committee member Dudley Whitehorn, who also participated in the trip to the Wind River Reservation, expressed a concern that the situation at Wind River with regards to oil and gas production is too distinct from the Osage situation to be instructive. He noted that the Wind River tribes have 2 million acres to lease and they have only one drilling rig active on all of that land. Whitehorn stated that it seemed to him that the Wind River tribes want to set up their own oil company and run their own operation. Whitehorn expressed skepticism about making changes to the Osage operation and asked how the changes that the Committee is contemplating would impact the 1906 Act. In response, federal officials stated that only Congress can change the 1906 Act and that the big plays at Wind River are gas plays. Since gas prices are low, there currently is not much drilling occurring in gas plays. Whitehorn expressed amazement that so little natural gas is being produced on so much land at Wind River and that everyone seems to have a problem with natural gas right now.

The parties discussed Amoco's withdrawal from drilling on Wind River sites. A federal Committee member explained that Amoco divested of its Wind River leases in order to concentrate on its offshore business and paid pretty well to assign the Wind River leases. The federal Committee member noted that there are some environmental impacts that will need to be addressed at Wind River because Wyoming does not have spacing regulations and Amoco seems to have overdrilled the fields. A federal Committee member noted that the major oil companies operate on the basis of long-term profitability and Amoco left Wind River when the easily-extracted oil had been extracted to move to more profitable offshore deposits.

Bear also asked what role BIA could play in helping the Osage gain access to all of their lands and why the BIA was not fulfilling this role. Committee members discussed the nature of the leases on the Wind River Reservation and federal officials noted that there are still some 1/8th leases in effect on Wind River lands. A federal official expressed appreciation that the Wind River tribes are able to access all of their lands as a lot of homesteading had taken place on Wind River lands.

Bear articulated an interest in visiting the Southern Ute Tribe to observe and discuss their operations at the recommendation of the Wind River tribes.

Calculating Gas Pricing in Oklahoma

Mitch Mouton, staff member to the Committee and Minerals Revenue Specialist with the Office of Natural Resource Revenue (ONRR), made a presentation to the Committee about how gas prices are calculated on Native American lands in Oklahoma. Mouton explained that the incentives of mineral rights owners and lessees can diverge when it comes to valuing minerals, such as natural gas, due to the royalties that lessees must pay to the owners of mineral rights, and as such the federal government has devised mechanisms to value natural gas. On Osage lands, the government uses index-pricing. Mouton briefly catalogued and explained the various conditions that would require natural gas to be subject to index pricing as well as the situations in which gas would be excluded from index pricing although it otherwise falls in an index zone. Mouton proceeded to explain how ONRR calculates the index-based value of natural gas in a given index zone, including the criteria that determine whether a publication (of natural gas prices) is included in the index calculation. Mouton further explained that ONRR applies a 10 percent discount factor (that cannot be less than 10 cents/MMBtu and cannot be more than 30 cents/MMBtu) to account for transportation costs and that no other allowance deductions are permitted against the index-based value. Mouton concluded his presentation by showing the Committee the page on ONRR's website where monthly prices for each of the six index zones are published and noting that ONRR provides the index-based value on its website. A reproduction of the presentation slides used by Mouton are posted on the Osage Reg-Neg website.

In response to Mouton's presentation, Committee members and staff discussed the following issues:

A staff member asked to clarify the basis for the index price in an index zone and Mouton reiterated that the index-zone price is based on the published highest prices of sales in an index area. Mouton also clarified that the 10 percent discount factor accounts for transportation costs. A federal Committee member noted that the index-pricing system was created as the result of a federal negotiated rulemaking process that including oil and gas companies, Native American representatives, and federal officials. Responding to a question from another federal Committee member, a federal Committee member stated that although pricing for oil is under review, pricing for gas is not under review.

Public Comment

Patrick Field, facilitator, introduced the procedure and ground rules for making public comments. Field noted that individuals who preregistered to make comments would comment first, followed by those who registered to make a comment on the day of the meeting, in the

order that registrations were recorded. Each commenter has up to five minutes to speak. Comments should be directed at the Committee as a whole, not at specific members of the Committee. Finally, Field requested that commenters keep their comments germane to the specific purview and work of the Committee.

The following public comments were received during the morning session of the meeting:

- Nona Roach stated that she has just a couple of comments. She said that it is fine if they conduct calibration every three months on the Wind River properties but that the problem on Osage lands is that some companies adjust BTUs every few months. One of these companies is Northwest Shell. A lot of other companies do not even adjust BTUs. Roach said that she spoke with BIA about this issue and reported that the Bureau said that it could not be adjusted. Roach said that she and her clients had some contracts for as low as 25 cents and said that that is a problem. Roach stated that the calibration itself is very rarely done. It is definitely not done every six months as people mentioned at the previous Osage Reg-Neg meeting. Roach said that the infrequency of calibration hurts the Osage because the tribe does not get the royalties that it is due and that the infrequency of calibration also hurts gas producers. Roach said that the only 1/8th leases out there are water floods and that these leases are a lot more expensive. Roach said that she also does several 1/6th leases. She said that she does not do any 20% leases. Roach said that she also works with Encana, but that Encana is just starting to drill in Osage County. Roach said that she is more concerned with the gas, and stated that she brought this issue to the attention of the first OMC. Roach said that, gas contracts can be updated as they are renewed. She also said that the Osage are getting only 25% of the gas right now. She suggested that the Osage could look at leases that are coming up for renewal and change the terms at that time. She said that the Osage are letting producers have gas contracts for 5-year leases. Roach said that she realizes that gas does not sell right now, but it could be the Osage's new oil. She said that that part needs fixing. Finally, Roach said that as far as CFRs [regulation from the Code of Federal Regulations], that there are various CFRs in place, but only the regulations relating to ingress and egress is being enforced. She said that that is what the people in the field have told her.
- Bob Jackman said good morning to the members of the Committee. He said that the first part pertains to operational efficiency that was brought up, to obtain efficiency of the whole operation. Jackman said that this effort encompasses BIA and the operators. Jackman said that the operators are not present and that they do not have a seat at the table. He said that the operators are the Osage's permanent partners. Jackman said that the Committee's deliberations are causing a lot of ill-will, around the issue of using NYMEX pricing. Jackman cited the significant mileage that oil must be transported from

Osage County to bring in to market. He said that credibility comes into play for those who are advocating for using NYMEX pricing and that it is a very complex issue. Jackman said that the oil pricing is to be subject to oil negotiation. He asked how come producers are being subject to oil pricing here? Jackman stated that the efficiency of the BIA Agency is known to be one of lowest in the nation. He said that it is understaffed and undertrained and that it needs to be retrained and bulked up. Jackman said that there is no auditing currently being done and that the Osage are hemorrhaging money. He said that the Osage must have mechanisms in place. Jackman submitted that the Osage put several members of Osage Petroleum Association and/or the Gas Purchasers on the Council in charge of governance. Jackman stated that the Osage could not do this without the producers. He said that what the Committee is not being told regarding NYMEX pricing is that the Osage will be hit with broker's fees and transmission charges. Jackman said that using the NYMEX price is not a smart strategy because it is a suppressed price and the Osage will run out of room. Jackman said that the Committee needs more experts, like Paul Tyler, and needs to incorporate the expertise of oil and gas producers. He said that there was too much ill will among the oil and gas producers. Jackman said that the Committee does not have any attorneys present and that it cannot approve multi-million dollar agreements without attorneys.

- Rob Lyon said that he did not want to be repetitive of the previous comments. He said that he was sorry that the Solicitor was not present. Lyon said that the process had been educational for him and that he had read CFR Part 226 from cover to cover. Lyon read excerpts from two leases which read, in part, that, "... settlement shall be based on the highest selling price...." Lyon explained that the reason that read from those leases is that those are agreements, contracts, between the Osage and producers. Lyon said that the Committee is basically saying that contracts that are in force are null and void. Lyon said that on Friday, he figured out that there are 2100 sections in Osage County, which means that there are over 8,000 quarter sections. Lyon said that, conservatively, there are probably 1000 lease contracts that are in force in Osage County and before the Committee goes too far down the road, he thought that it should consider the ramifications. Lyon said that he knew a Committee member would want to know, and so the first lease that he read from was a 1/6th royalty and the other was 3/16th royalty.
- Linda Heskett introduced herself as a restricted Osage shareholder. She said that much of the Committee's discussion had been over her head. She noted that at Shareholder meetings, there is always an executive session. She said that the Committee was not discussing gas, which is the new oil. Heskett stated that any regulations should be beneficial to shareholders and should be somewhat beneficial to producers. She requested that when the Committee come to a rule, that it please put it in lay terms for shareholders to understand, and that this would be appreciated. Heskett said that

when the tribe is making contracts with the producers, an oil and gas attorney needs to be present. And she said that the Osage shareholders need to be privy to it.

- Julie Wilson introduced herself as a restricted Osage shareholder and a member of the Osage Tribe. She said that shareholders are still getting the amount of money they got in 1984. She said that headright income is about the same as at that time. She said that she did not understand why the shareholders were getting so little of oil money and why the producers were getting most of it. Wilson stated that everyone should be on the same rules, including big companies and small companies. She said that if any producers do not want to abide by the Osage' rules, that those companies should step down because there are other producers who want to come in.
- Frederick Drummond introduced himself as a small independent producer who is primarily a rancher. He said that one of his concerns is that existing contracts that the tribe has could be abrogated. Drummond stated that that is a very serious thing. He said that by invalidating contracts that are in place, by saying that a producer is not producing enough oil, the tribe would lose their credibility. Drummond stated that this would make it hard for the Osage to attract future business. He said that it is very important to honor current contracts. Drummond said that operators have a problem with the BIA not having enough funds. He said that he also want to comment on the issue of tying the royalties to NYMEX pricing. He said that NYMEX values are predicated on derivatives. Drummond said that NYMEX pricing is controlled by speculators and hedge funds, not by producers or people involved in business. He said that it is a speculative idea for how to sell the product, and it is not a solid basis for the oil industry or for the tribe.
- Mark Helmer introduced himself as a small producer. He said that his family had built up their business over 30 years. Helmer explained that one of the fears of the small producers is that they do not have blanket concessions. He said that his firm has some leases that have 10 to 12 wells on them. Helmer said that he was afraid that the Osage were going to be taking away 140 acres. He said that his company does not have the money to drill all the wells at once, but that they drill diligently. He said that this is what a lot of the small producers are concerned about.

In response to questions and comments posed during the public comment period, the Committee and staff provided the following information:

- A staff member to the Committee said that he wanted to address the comments regarding abrogating contracts. He explained that the Osage would not be abrogating contracts and that is not what the Committee was discussing. He explained that each of the leases that the Osage have entered into specifies that the lease is subject to changes in regulation. The staff member noted that many regulatory changes have been made

in the past, and many of these have favored operators. He noted that there are some exceptions that limit certain regulatory changes, but that the proposed changes that the Committee is discussing would not constitute abrogation of leases.

- An Osage Committee member said that it seemed that the Osage are not currently getting the NYMEX price due to transportation costs. He asked whether any sort of standard exists on transportation costs. Another Osage Committee member responded that he had received a lot of feedback from operators regarding the issue of the highest listed price versus NYMEX pricing. He said that he was trying to set up a meeting with producers for November 9 that would tie into the Oil and Gas Summit scheduled for November 7 and 8. The Committee member explained that, at the November 9 meeting, an oil and gas expert would be present to answer questions for producers and purchasers. He also said that he would explore further the issue of how the highest listed price was arrived at.
- A Mineral Council's advisor requested that producers submit transportation costs and economic analyses at the November 9 meeting. Another Osage Committee member clarified that the Osage Minerals Council would seek to understand and exchange views with producers and purchasers at the November 9 meeting but would not be seeking to reach consensus on any issues that day.
- Continuing on the theme of trying to understand transportation costs, an Osage Committee member asked how transport via truck could be compared to transport via pipeline. A staff member to the Committee explained that unless the pipeline system is regulated and rates are set by tariff, transportation is negotiated between the system operator and individual clients. As a result, it does not really make sense to set a standard price for transportation, because there will be different negotiated rates. This is why the ONRR index pricing includes a standard 10% discount factor to account for variable transportation costs. Committee member Bear noted that the Wind River tribes know what each operator is paying in transport costs as that information is written into the leases and contracts. As such, the tribe knows how much each producer is making.
- An Osage Committee member stated that if a producer is holding a quarter section and is producing in paying quantities, then the Committee is not discussing taking anything away from that producer. Currently, the Superintendent has the authority to tell the producer to drill further if that's what a "prudent operator" would do.

Production Accountability

Committee member James Stockbridge made a presentation to the Committee about the work of the Production Accountability and Royalty Compliance Subcommittee. Stockbridge

explained that the goal of the subcommittee was to modify regulations in order to enhance both production accountability (verifying that the oil and gas produced has been accurately measured and reported) and royalty compliance (verifying that the royalty paid is the correct amount). Stockbridge also noted that successful regulations would support proper quantity measurement, proper quality determination, proper reporting, proper receipt of sales price and sales volume information, and proper royalty payment verification. He explained that there are a variety of tools available to address the issues that need addressing, and that the most nimble, appropriate tool should be applied to each of these issues. Importantly, that means that all issues do not merit a regulatory change. Stockbridge summarized the advantages and disadvantages of using each of five tools. After providing this background on the purpose and scope of the Subcommittee, Stockbridge reviewed the purpose of the site visit to the Osage Agency undertaken by the Subcommittee members and reviewed what was accomplished during that site visit. Stockbridge closed by highlighting future action items for the Subcommittee's work. A reproduction of the presentation slides used by Stockbridge are posted on the Osage Reg-Neg website.

Committee member Galen Crum, also a member of the Production Accountability and Royalty Compliance Subcommittee, noted that he and Stockbridge largely conducted an assessment during their site visit to the Osage Agency. He stated that now that he and Stockbridge have a better sense of the overall picture, they will need to see which tools are most appropriate for resolving various issues.

In response to Stockbridge's presentation, Committee members and staff discussed the following issues:

- A number of the Osage Committee members noted that regulations need to be enforced, not just written. In addition, sufficient funding will need to be provided to the Osage Agency to allow it to fulfill its enforcement responsibilities. An Osage Committee member noted that it has taken the Wind River tribes years to get to their current performance standard. In response to these comments, Stockbridge stated that enforcement is contingent on having appropriate regulations in place. For those areas, such as royalty compliance, where appropriate regulations are already in place, enforcement can begin immediately, and where new regulations are needed enforcement will have to wait until these new regulations are in place.
- In response to a question about next steps for the Production Accountability and Royalty Compliance Subcommittee, Stockbridge and Crum stated that the Subcommittee would identify different issues and place them into different categories as per the most appropriate tool to address the issue. The Subcommittee will also review the proposed language from the Osage Minerals Council, as well as the existing

BLM and ONRR regulations, and will craft draft regulatory language drawing on these sources.

Drilling Obligations

Merrill Godfrey, staff member to the Committee and Counsel for the Osage Minerals Council, presented the proposed revisions of the Drilling Obligations Subcommittee to 25 C.F.R. § 226.9. Godfrey stated that the main purpose of the most recent round of proposed revisions was to clarify language that may have been overly broad or confusing and to bring the regulations in line with the regulations that are in place in other parts of Indian Country. The current iteration of 25 C.F.R. § 226.9 is included in Attachment E. The edits presented are amendments to the previous version of the regulations, as discussed by the Committee, and do not represent the final version of the regulations.

The themes discussed by the Committee in relation to the subcommittee's recommendations included the following:

- Whether it would be possible to secure additional funds from the BIA for the Osage Agency.
- How the 30-day lease termination for non-production clause would apply in case of circumstances that are outside of the control of the operator, for example a hold by the Environmental Protection Agency. An Osage Committee member noted that the Osage Minerals Council has the power to renegotiate leases and reinstate terminated leases.
- The definition of "non-production" under the 30-day lease termination for non-production clause. A federal Committee member explained that non-production is defined as an operator failing to report production during a 30-day period in the ONRR system.
- The potential financial consequences for an operator who causes a blowout rendering a well inoperable. Committee members discussed whether it made sense to create regulations by which the Osage would receive payment in such a circumstance in terms of balancing between the damage caused to the Osage mineral estate and increasing the cost of doing business for an operator.
- The operation of the "prudent operator" clause. A staff member to the Committee explained that production in "paying quantities" is determined by a well-defined formula in use by the industry.
- The pros and cons of including draft regulatory language in the meeting summaries. The Committee agreed to include draft regulatory language in the meeting summaries with the inclusion of text stating that the text is still in draft form and may change before the final regulations are approved.

Public Comment

Patrick Field, facilitator, introduced the procedure and ground rules for making public comments. Field noted that individuals who preregistered to make comments would comment first, followed by those who registered to make a comment on the day of the meeting, in the order that registrations were recorded. Each commenter has up to five minutes to speak. Comments should be directed at the Committee as a whole, not at specific members of the Committee. Finally, Field requested that commenters keep their comments germane to the specific purview and work of the Committee.

The following public comments were received during the afternoon session of the meeting:

- Shane Matson thanked the Committee and said that he found a description of overall production in Osage County to be missing from the Committee's conversation. He said that that conversation includes the mineral estate, purchases, etc. Matson laid out some questions that he would like to see addressed, including: what is the current oil production in Osage County? What is the current gas production? Matson said that he knows the answer to both of those questions and everyone on the Committee should also know. Additional questions include: How have production trends changed over past 5, 10, and 25 years? Matson said that that information needs to be brought into the Committee's conversation. Matson said that he also wants to know how large BIA's budget is in Pawhuska and what it is spent on. Matson stated that today, there is unprecedented capital being risked by producers. He said that he suspected that the formula that matters is taking the drilling dollars and taking the BIA annual budget and putting one into the other. Matson closed by saying that BIA's office is woefully understaffed to do a very demanding job and that they need more people.
- Julie Wilson introduced herself as a restricted Osage shareholder and a member of the Osage Tribe. She said that the Committee should not make concessions when times are good. She said that the concern of some of the other commenters is with the producers, not with the shareholders, where it belongs. Wilson said that the Committee should keep this in mind when it listens to the comments.
- Linda Heskett asked, in relation to drilling obligations, why an oil and gas attorney would see that something is not right. She asked where it stops. She asked who has the last say and final authority.
- Ray McClain introduced himself as an Osage Shareholder and distributed a written copy of his comments, which are included in Attachment D. Prior to reading his comments, McClain thanked Curtis Bear for alleviating his fears that no one is thinking about how this will be paid for. McClain's comments focused on urging the BIA to provide the

funding and expertise needed to implement the necessary improvements to management of the Osage mineral estate.

- Bob Jackman said that he would speak again, due to popular demand. He said that the day is long and he appreciated the Committee's points. He noted that part of his comments would be redundant. Jackman asked where the other partner is, the operators, in this exchange. He emphasized that producing oil and gas is a business, and the operators are risking money. Jackman said that it is not as if there is an ocean of oil under Osage County and it is not so simple to simply just drill down and pump it up. He estimated that 50-60% of wells drilled in Osage County are dry. Of the remaining 50%, 35% of those were not commercial wells (in other words, the operator paid for completion, but the drilling just did not work out). Jackman concluded that drilling is a high-risk business. He said that the gentlemen drilling the \$2-4 million horizontal wells, some of those do not pay out. Jackman admitted that there are some operators who do not report properly. He said that the Committee keeps talking about the prudent operator but he wanted to talk about a prudent Superintendent. He said that the Committee is discussing a \$4 billion mineral estate. Jackman said that it is necessary to have a Superintendent who is experienced in the oil and gas industry and who knows about each aspect of oil and gas exploration and the Superintendent needs to have advisors of high quality. Jackman said that the Osage estate is the only estate of its size that does not have a single petroleum geologist on staff. Jackman said that these are some basic points that he has brought up in the past and wanted to bring up again. He said that the producers are partners with the Osage and will be with the Osage for another 100 years. He advised the Committee not to bring up things while having full knowledge that they will cause ill will.
- Matt Beavers said that he wanted to point out that a prudent operator could still be prudent without producing in a given month. He said that parts wear out and other things can happen. In busy times, work trucks are not just sitting by the side of the road that a producer can just get at any time. Beavers said that he is kind of new here and that he does not know about specific clauses, but he thought that there should be an opportunity for accommodation. He said that his company, Devon Energy, would like to think of themselves as prudent operators, even if they do not produce in a given month. Beavers said that, just because 30 days had passed did not mean that production would not come back on line.
- Dan O'Toole introduced himself as with Encana Oil and Gas. He said that he definitely stands with other operators regarding the NYMEX pricing issue. He said that the value of oil and gas is the value that producers receive. O'Toole said that the NYMEX price is a made-up index. He said that there is a lot that is going right in Osage County today. O'Toole said that the Committee should understand that there are 5 or 6 plays going on

that are very similar and funds will be directed to those plays that are most economical. He said that the Committee's NYMEX proposal will affect the economics of producing in Osage County. He said that the Osage have done a good job of identifying their issues with the BIA. O'Toole said that his issue is that his firm had not anticipated hiring a consultant just to submit paperwork to the BIA. He said that he would like to close by saying that the big picture here is an opportunity for the Osage Tribe to become involved with managing their own mineral estate. O'Toole said that if there was a way that the Osage could educate their own people to manage their estate, that would be the best thing. He thanked the Committee.

- Nona Roach said that she was thinking about the way that the Committee is discussing terminating leases. She asked whether Committee members know what the current time limit is for termination. She said that it currently is non-production for a year. Roach said that 30 days is not enough. Roach said that, for example, if a producer has a disposal well down, the producer does not have any place to go with that water. She said that the operator cannot operate efficiently if they have to pay someone to haul off their water. She said that operators cannot even get their permits approved in a timely fashion. Roach said that when she called to check up on an application that one of her clients submitted, it had not even been logged in for 5 days. She said that the problems with the termination is that, whatever it is that triggers a field guy to go out and inspect the field, that triggers a 15-day show-cause letter. It can take 2 months just to find a pulling unit. Roach said that mom and pop operators cannot get these quickly. She said that small operators are way down on the totem pole. She asked what happens when the electricity goes out for a snowstorm. She said that it can take 3 months just to get the power back. Roach asked what happens if a lease that is producing at 2 to 3 barrels per day goes to concession and the big producer may not want to produce in that area at all.
- Chris Clemishire introduced himself as a member of the Osage Producers Association and with B&G Oil Company. He said that he was not going to throw out numbers and all of that. He said that he wanted the Committee to consider that oil has been pretty good recently, but what goes up comes down. He pointed out that oil has been at \$9 per barrel. Clemishire said that he wanted the Committee to remember the small man, and he promised that small producers would be in Osage County even when prices go down. He said that his family lives in Osage County and that is all that they know. He said that his firm does not come in and drill horizontal wells. He urged the Committee to think about the small man and because they would be in Osage County to stay.
- Tom Lackey introduced himself as with Chaparral Energy. He said that the audience has heard a lot of comments regarding the understaffing of the Osage Agency. He said that if the operators start calling the Agency about secession or release it would impose

another burden that it cannot accommodate. He said that if the Committee is discussing about a 30-day non-production standard, then the amount of work increases even more.

- Jamie Sicking said that the Agency does not have the resources to do the work that it is supposed to be doing now. If the Committee moves to a 30-day standard, the work would increase significantly and the Agency cannot even handle the work that it wants to do now.

In response to questions and comments posed during the public comment period, the Committee and staff provided the following information:

- An Osage Committee member noted that there had been several comments about terminating 2 to 3 barrel per day leases and the Committee was not discussing anything new there as the regulation to produce in paying quantities had been on the books. The Committee member added that the Osage have had a 60-day non-production standard, but that the rest of Indian Country had been moving to a 30-day standard, but the Committee was open to considering retaining the current 60-day standard.
- A federal Committee member added that if there are adverse circumstances that prevent a well from producing, such as a snowstorm or a power outage, it is the producer's responsibility to request a suspension of operation from the Agency and this would stop the clock.
- An Osage Committee member noted that the Osage Minerals Council Executive Committee had always accommodating to producers who came to the Executive Committee to explain their situation and would continue to be so.

Other Agenda Items and Work Planning for Future Meetings

- The Committee reached agreement to approve the meeting summary from the September Osage Reg-Neg meeting.
- Members of the Osage Minerals Council intend to visit the Southern Ute Reservation to discuss electronic reporting, coordination with ONRR, and other issues.
- The Production Accountability and Royalty Compliance Subcommittee will present an update on its work at the November meeting.
- The Modernizing Royalties for Oil and Gas Production Subcommittee will report to the Committee on its further work, including its meeting with producers and purchasers that is scheduled for November 9.

After a closing prayer, the Designated Federal Officer adjourned the meeting at 3:21 pm.

Attachments

- A. Attendance
- B. Action Items
- C. Materials Distributed to the Committee
- D. Written Public Comments Submitted
- E. Attachment E: Proposed Revisions to 25 C.F.R. § 226.9

Attachment A: Attendance
Osage Negotiated Rulemaking Committee
Meeting 3 – October 22, 2012

COMMITTEE MEMBERS

Last Name	First Name	Organization	Principle or Alternate
Abbott	Sonny	Osage Minerals Council	P
Bear	Curtis	Osage Minerals Council	P
Crum	Galen	Osage Minerals Council	P
Yates	Andrew	Osage Minerals Council	P
Core	Melvin	Osage Minerals Council	P
Red Eagle	Myron	Osage Minerals Council	A
Whitehorn	Dudley	Osage Minerals Council	A
LaCounte	Darryl	Department of Interior, Bureau of Indian Affairs, Deputy Regional Director-Trust Services, Rocky Mountain Regional Office	P
Manydeeds	Stephen	Department of Interior, Assistant Secretary-Indian Affairs, Chief, Division of Energy and Mineral Development	P
Stockbridge	James	Bureau of Land Management, Trust Liaison and ONRR Liaison	P
Tyler	Paul	Office of Natural Resources Revenue, Program Manager, State and Indian Coordination	P

AGENCY AND OTHER STAFF

Last Name	First Name	Title	Organization
Godfrey	Merrill	Legal Representative	Akin Gump, <i>for</i> Osage Minerals Council
Reineke	Dan	Consultant	Consultant <i>for</i> Osage Minerals Council
Mouton	Mitch	Minerals Revenue Specialist	Office of Natural Resource Revenue
Dalton	Kenneth	Legal Representative	Department of Interior, Office of the Solicitor
Streater	Eddie	Alternate Designated Federal Officer	Bureau of Indian Affairs
Stills	Candace	Administrative Support Assistant	Bureau of Indian Affairs, Eastern Oklahoma Region
Loftin	Rhonda	Acting Deputy Superintendent	Osage Agency
Canady	Cammi	Realty Assistant	Osage Agency
Field	Patrick	Facilitator	Consensus Building Institute

Kansal	Tushar	Facilitator	Consensus Building Institute
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MEMBERS OF THE PUBLIC

Last Name	First Name	Public Comment
Abbot	Ann	N
Beavers	Matt	Y
Blue	Burdette	N
Clemishire	Chris	Y
Cox	Dewey	N
Cox	Jerry	N
Dionisio	Monica	N
Drummond	Frederick	Y
Graham	Marion	N
Haack	Ken	N
Helmer	Mark	Y
Heskett	Linda	Y
Jackman	Bob	Y
Jacobson	Deborah	N
James	Brad	N
Lackey	Tom	Y
Lacy	Heather	N
Lindsey	Amy	N
Long	Sharon	N
Lyon	Rob	Y
Matson	Shane	Y
McClain	Ray	Y
Meyer	Jane	N
Phelps	Floyd	N
Roach	Nona	Y
Ross	Brian	N
Rougeot	Jason	N
Rougeot	John	N
Sicking	Jamie	Y
Sullivan	Bob	Y
O'Toole	Dan	Y
Waller	Everett	N
Wilson	Julie	Y

Attachment B: *Draft Summary of Action Items*
Osage Negotiated Rulemaking Committee
Meeting 3 – October 22, 2012

Task	From	Deadline
Arrange next meeting location	OMC	Early November
Prepare meeting summary	CBI	Early November
Visit Southern Ute Tribe to discuss electronic reporting, coordination with ONRR, and other issues	OMC	
Prepare a presentation about § 202 and the potential implications on the 1906 Act of the Osage assuming auditing authority under §202for the Committee to be delivered at the November Osage Reg-Neg meeting	Federal Committee members	November 13
Identify and categorize salient issues. Review proposed language from the Osage Minerals Council, and existing BLM and ONRR regulations. Craft draft regulatory language.	Production Accountability and Royalty Compliance Subcommittee	November 13
Publicize meetings in advance via Federal Register and Osage Minerals website and other means	DOI	Late October
Organize next detailed meeting agenda	Co-Chairs	Early November
Create and maintain a public repository with hard copies of all Committee materials at a location accessible to the public during business hours	OMC	Late October

Attachment C: *Materials Distributed*
Osage Negotiated Rulemaking Committee
Meeting 3 – October 22, 2012

1. Final Agenda
2. Draft Meeting Summary from Meeting #2
3. Reproduction of slides from Production Accountability and Royalty Compliance Subcommittee presentation
4. Draft markup of 25 C.F.R. § 226.9
5. Written public comment submitted by Dan O'Toole

Attachment D: Written Public Comments Received
Osage Negotiated Rulemaking Committee
Meeting 3 – October 22, 2012

Comments for NRC Meeting

Oct. 22, 2012

All the changes necessary to get the Pawhuska BIA/Osage Agency up to speed are going to cost many millions of dollars. The Osage Shareholders, through our Osage Minerals Council members who were a part of the Highest Posted Price Trust Team, agreed to a \$380 million dollar settlement, PLUS doing all the things necessary to get the Agency up to speed and into the 21st century. We got the cash. We can see the gears of negotiation beginning to turn, and we expect the improvements to start happening soon. We will never know how much cash we left on the table, and we can only hope that we made the right decision. We hope that we will not be disappointed.

Is there an estimate yet on how much this is actually expected to cost in dollars for equipment and software and existing data input?

Is there an estimate yet on how many additional dollars will be allotted annually for a permanent increase in the number of qualified personnel to monitor and maintain the system efficiently? If a new system is put in place, and then is not continually updated as new information becomes available, we will very quickly be right back in the same old ruts of unaccountability we have been forced to live with for way too many years already.

As an Osage Shareholder, I would hope the BIA could soon reaffirm to us that they intend to honor their commitment made at settlement, and are prepared to provide the funding and the expertise needed to implement the necessary improvements.

Ray McClain, Osage Shareholder

Wilson, Letha

From: O Toole, Dan <Daniel.O'Toole@encana.com>
Sent: Thursday, October 18, 2012 1:22 PM
To: IA OSAGEREGNEG
Subject: Encana's comments on-Osage Negotiated Rulemaking
Attachments: FINAL Encana Response to Osage Minerals Council Proposed Changes to CFR.doc

Mr. Streeter:

Attached is Encana's response to Osage Minerals Council proposed changes to CFR 226.

Encana is pleased to be a part of the process and looking forward to participating in any changes, recommended by the committee, to improve the efficiency of the BIA in handling the increased work flow in Osage County.

Respectfully,

Dan P. O'Toole

Dan P. O'Toole
Land Negotiator
Encana Oil & Gas (USA) Inc.
5851 Legacy Circle
Plano, TX 75024
tel: 469-304-6320
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Dan.O'Toole@Encana.com

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<http://www.encana.com>

1. Modernize royalty value and royalty rate for oil production

"Royalty should be set using the average NYMEX daily price of oil at Cushing, Oklahoma, plus a premium."

Encana Response: In the midcontinent region, which includes Osage County, oil prices paid by purchasers are likely to be related to the physical posting of a Cushing, Oklahoma, barrel. The differential, if any, between the Cushing price posted by the purchasers and the price paid to the seller is dependent on oil quality and the cost of transportation to the market. Encana anticipates that for oil sold in Osage County the differential will be negative due to the cost of transportation to the market.

"Royalty rates should be no less than 20% for oil."

Encana Response: Encana has no objection to a 20% royalty rate at the present time. Please note, however, that if the price of oil trends lower, the higher royalty rate would adversely affect the economics of drilling, and could lead to a decrease in drilling activity.

2. Modernize royalty value, royalty rate and royalty calculations for gas production

"Royalty value should be set using the Monthly Index Price in dollars per MMBtu for Oklahoma Zone 1 published by the Office of Natural Resources Revenue."

Encana Response: Producers are paid for their gas production based upon the quality of the gas sold, i.e. BTU content and associated liquids (if any). The producers generally market their gas to a third party who has built a gathering system to transport the gas to market. In return for transporting the gas, the third party gas gatherer charges the producer a gathering fee which is deducted from the sale price. If the producers were forced to pay royalty on the basis of an average monthly index price without the transportation deductions this would effectively increase the royalty, which, coupled with the prospective increase in the royalty rate to 20%, would have a significant impact on

a producer's return. As noted above, this will have an effect on a producer's drilling decisions.

"Royalty rates should be no less than 20% for gas."

Encana Response: See answer under 1, above.

"Royalties should be based on a 'keep whole' by measuring the total volume at the well and multiplying by MMBtu's and by royalty value."

Encana Response: Again this has a negative effect on the producers' economics having to pay for all costs associated with making the gas marketable and transporting the gas to the sales point.

3. *Strengthen drilling obligations for oil leases*

"Lessees should be held to prudent operator standard, and the Superintendent's authority to order drilling and terminate leases should be clarified."

Encana Response: Encana has no problem with a prudent operator standard but would like an opportunity to review the proposed changes to the Superintendent's authority to order drilling and terminate leases. Most jurisdictions with significant oil activity use the prudent operator standard to measure a lessee's performance under the lease. Under Texas law, for example, development of a lease and protection from drainage are measured by the activities of a prudent operator. At the same time, those jurisdictions hold the lessee responsible in damages, and rarely resort to lease termination as a penalty. Encana believes this is an effective standard that leads to certainty for both lessor and lessee.

4. *Require detailed electronic reporting by all lessees*

"Detailed monthly statements and all run tickets should be submitted electronically on a monthly basis and forwarded to the Minerals Council on a quarterly basis."

Encana Response: Encana has no issues with this proposed change; we currently remotely monitor all production on a daily basis and have the capability to provide reports as requested.

5. **Strengthen oil gauging and gas meter inspection, calibration and adjustment**

“Lessees should be required to inform the Superintendent before purchasers are notified that oil is ready to be removed from the lease, so the Superintendent can perform unannounced gauging of the tanks. Advance notice should also be required for gas meter inspections, calibrations, and adjustments and they should be performed no less than twice a year for each well.”

Encana Response: Encana has the capability to report production and tank gauge readings electronically on a daily basis if needed. The idea of notifying the Superintendent of a pending haul could lead to a logistics problem since pick-up times can be unpredictable. Oil is hauled, by truck, on the basis of 180 barrel loads, so on a prolific well oil may be hauled on a daily basis, or even more frequently. This would pose a significant administrative burden on both the state and the producer. Additionally, Encana would request that the Superintendent notify Encana of their intent to gauge tanks, if necessary, so that all safety requirements are met before gauging the tank. Encana would be able to provide the Superintendent with notification of all scheduled gas meter calibrations and tank probe calibrations at least two days prior to calibration using eMaint, a web based portal.

Attachment E: Proposed Revisions to 25 C.F.R. § 226.9
Osage Negotiated Rulemaking Committee
Meeting 3 – October 22, 2012

§ 226.9

Rental, drilling, and production obligations.

(a) Oil leases, gas leases, and combination oil and gas leases. Unless Lessee shall complete and place on production a well producing and selling oil and/or gas in paying quantities on the land embraced within the lease within 12 months from the date of approval of the lease, or as otherwise provided in the lease terms, or 12 months from the date the Superintendent consents to drilling on any restricted homestead selection, the lease shall terminate unless rental at the rate of not less than one half the Indexed Fee Amount per acre for an oil or gas lease, or not less than the Indexed Fee Amount per acre for a combination oil and gas lease, shall be paid before the end of the first year of the lease. The lease may also be held for the remainder of its primary term without drilling upon payment of the specified rental annually in advance, commencing with the second lease year. The lease shall terminate as of the due date of the rental unless such rental shall be received by the Superintendent, or shall have been mailed as indicated by postmark on or before said date. The completion of a well producing in paying quantities shall, for so long as such production continues, relieve Lessee from any further payment of rental, except that should such production cease during the primary term the lease may be continued only during the remaining primary term of the lease by payment of advance rental which shall commence on the next anniversary date of the lease. Rental shall be paid on the basis of a full year and no refund will be made of advance rental paid in compliance with the regulations in this part.

(b) The Superintendent may, with the consent of and under terms approved by the Osage Minerals Council, grant an extension of the primary term of a lease.

(c) Irrespective of whether the Lessee has drilled or paid rental, the Superintendent in his discretion may order further development of any leased acreage or separate horizon in any lease term if, in his opinion, a prudent operator would conduct further development. A prudent operator will diligently develop the minerals underlying the leasehold. The Osage Minerals Council shall have the right to request such a determination by the Superintendent as to any lease and may submit any materials or analysis it deems appropriate. Upon receipt of such a request, the Superintendent shall issue such a determination within 90 days.

(d) If Lessee refuses to comply with an order by the Superintendent under (c), the refusal will be considered a violation of the lease terms and said lease shall be terminated as to the acreage or horizon the further development of which was ordered. The Superintendent shall notify the Lessee of such termination.

(e) Except for a lease during its primary term for which rental payment is not yet due or has been paid, a lease that does not produce in paying quantities for one calendar month is thereby terminated, effective immediately. The Superintendent shall notify the Lessee of such termination.

(f) Whenever the Osage Minerals Council identifies any lease that has terminated or may be subject to termination for any reason, the Osage Minerals Council shall have the right to request in writing appropriate action by the Superintendent, including but not limited to the issuance of a notice of termination to the Lessee, and may submit any materials or analysis it

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deems appropriate. Upon receipt of such a request, the Superintendent shall within 90 days either take the requested action or issue a written decision responsive to the request.

(g) The Superintendent may impose restrictions as to time of drilling and rate of production from any well or wells when in his judgment, such action may be necessary or proper for the protection of the natural resources of the leased land and the interests of the Osage Tribe. The Superintendent may consider, among other things, Federal and Oklahoma laws regulating either drilling or production. If a lessee holds both an oil lease and a gas lease covering the same acreage, such lessee is subject to the provisions of this section as to both the oil lease and the gas lease.

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