

OSAGE TRIBE/BIA NEGOTIATED RULEMAKING

Encana Oil & Gas (USA) Inc.

Comments and Recommendations to Proposed Revisions to 25 CFR 226

**226.6 Sub (b) Bonds**

*Comment:* The nationwide bonding program applies to other federal lands and has been shown to effectively mitigate risk.

*Recommendation:* Reinsert (b) nationwide coverage

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**226.9A Drainage; Compensatory Damages**

*Comment:* Encana does not believe the Superintendent has the resources available to make the final determination concerning drainage in Osage County under the proposed scheme. Since the Osage Nation owns all the minerals in the county, the determination of drainage is entirely an economic consideration based upon differing royalty rates. This greatly increases the complexity of the calculation for the Superintendent, while simultaneously decreasing the operator's certainty in planning wells. Rather than monitoring the geologic environment to determine the necessity of offset wells on its leases, an operator will be forced to monitor the royalty rates of surrounding leases. Then the operator will be required to make an economic, rather than scientific, determination of whether an offset well will be required – the economics being the relative value of the additional well to the Osage Nation, not the relative value to the operator. Encana believes this will lead to the drilling of unnecessary wells and the waste of resources.

*Recommendation:* Delete all reference to compensatory damages.

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**226.11 Sub (a) (2) Oil Settlement Value**

*Comment:* Because the NYMEX price for oil is determined at a market hub, it does not take into account the price differential due to distance from the hub. Because of the basis differential, it is unlikely in the extreme that any operator in Osage County will ever realize the NYMEX price for its oil. The "greater of" formulation of this proposed provision, therefore, is actually only an effective increase of the royalty percentage over the statutory rate and will be paid out of the operator's pocket.

Additionally, in order to pay the royalty timely under the rules, the purchasers of production pay the royalty. The "greater of" formulation poses two significant problems for the purchaser/payor. The payor will be required to perform, each month, a manual calculation of the proper royalty payment; such a manual calculation will mean that the payor's normal accounting software cannot be used to calculate and pay the royalty. This will slow the payment process and greatly increase the payor's

administrative overhead costs. The second, and perhaps greater, problem is that the operator's entitlement to proceeds will be different each month – meaning that the purchaser will either have to manually calculate the operator's share of production each month also, or pay the operator according to his percentage share of the proceeds and go out of pocket for the difference until the operator reimburses it. All of which is to say that the "greater of" formulation will place tremendous additional administrative, and possible financial, burdens on the purchaser.

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*Recommendation:* Strike all reference to NYMEX pricing; This seems to be only fair, unless the intent of the committee is to increase the royalty payment at the direct expense of the operators. If this is the case, then we recommend the following;

Insert after "sold" in (a) (2) "less transportation costs to Cushing, Oklahoma".

Insert "for determining royalty price" in (a) (4) after "NYMEX Price".

Delete the last sentence of (a) (4).

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#### **226.9 Sub (e) (1) Termination of Lease**

*Comment:* Although the operator may request a temporary suspension of operations within 45 days after cessation of production, Encana believes the inclusion of a 90 day continuous operations clause (spending money to reestablish production) should be included that would automatically extend the lease. Such a clause is consistent with the way most private oil and gas leases function.

*Recommendation:* "If all production on a Lease or lands consolidated with the Lease should cease from any cause after the primary term, then in the event the Lease is not otherwise being maintained in force, the Lease nevertheless shall continue in force and effect as long as additional drilling operations or reworking operations are conducted on the Lease or on any acreage consolidated with the Lease within 90 days after cessation of all production, which additional operations shall be deemed to be had when not more than 90 days elapse between the cessation of operations on one well and the commencement of operations on another well or if production is obtained this Lease shall continue as long as oil and/or gas are produced in paying quantities from the lease or acreage consolidated with the Lease."

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#### **226.11 Sub (b) GAS ROYALTY**

*Comment:* As noted above with respect to oil, index prices do not reflect the prices operators realize for their production in the field; most often the price difference is a result of transportation costs and gas quality, although it can also result from market saturation. Index prices are established for pipeline quality gas, mostly free of impurities and of approximately 1000 Btu's per 1000 cubic feet of gas. Gas produced from the wells in Osage County must, in almost all instances, undergo treatment of one sort or another in order to meet those standards. Also, as with oil, the index prices are for gas at a market hub. The operator incurs gathering and transportation costs which will also reduce the realized price below

the index price. Therefore, as with oil, a requiring that royalty be paid on the “greater of” an index price or the amount realized will effectively mean that the royalty percentage is increased over the statutory rate, an increase that will be paid entirely out of the operator’s pocket.

Additionally, as discussed above with respect to oil, in order to pay the royalty timely under the rules, the purchasers of production pay the royalty. The “greater of” formulation poses two significant problems for the purchaser/payor. The payor will be required to perform, each month, a manual calculation of the proper royalty payment; such a manual calculation will mean that the payor’s normal accounting software cannot be used to calculate and pay the royalty. This will slow the payment process and greatly increase the payor’s administrative overhead costs. The second, and perhaps greater, problem is that the operator’s entitlement to proceeds will be different each month – meaning that the purchaser will either have to manually calculate the operator’s share of production each month also, or pay the operator according to his percentage share of the proceeds and go out of pocket for the difference until the operator reimburses it. All of which is to say that the “greater of” formulation will place tremendous additional administrative, and possible financial, burdens on the purchaser.

*RECOMMENDATION:* Allow for transportation deduct.

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### **226.19 Sub (b) Use of Surface Land**

*Comment:* Because of the safety requirements for flare setbacks, truck turning radius around larger tank batteries and equipment requirements for longer horizontal wells, changes are required to the drill pad size language as follows:

*Recommendation)* “A drilling site shall be held to the minimum area essential for operations and shall not exceed two and one-half acres in area for each horizontal well and one and one-half acres in area for each vertical well, unless authorized by the Superintendent.”

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### **226.19 Sub (c)**

*Comment:* Tank site fees should only apply to permanent tanks installed at sites which are not located on the drilling site-all of the drilling site damages are covered under Section 226.21. Because of small size of pads allowed in the Osage and the large volumes of water that need to be temporarily stored in tanks situated near the drill site in fracking a horizontal well, the language on the temporary tanks

should be modified to allow temporary tanks to be located off of the drilling site but nearby. It would be best to clarify and suggest the following changes to the language regarding payment for tanks:

*Recommendation:* (c) "Lessee shall also pay fees for each tank site associated with a given well or group of wells at the rate of \$500 per tank except that

(1) no payment shall be due for tanks temporarily set on or near a drilling site for drilling, completing, or testing, and

(2) the sum to be paid for a tank site occupying an area more than 2500 square feet per tank shall be agreed upon between the surface owner and lessee or, on failure to agree, the same shall be determined by arbitration as provided by Section 226.21."

(3) no payment shall be due for tanks set on a drilling site.

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#### **226.38 SUB (B) MEASURING AND STORING OIL**

*Comment:* Encana's current horizontal well program has resulted in wells with initial production rates of many hundreds of barrels per day. Oil purchasers are therefore hauling as many as 10 loads per day, around the clock. Because storage for oil on location is limited, any delay in hauling the oil will require that wells be shut in – with the concomitant danger of formation damage that poses. Delays in hauling the oil would also increase the risk of spills. For such wells, it will be necessary to give notification to the superintendent outside of normal business hours. Therefore it would appear to benefit both parties to stipulate notification by email, text or phone message.

*Recommendation:* Include language providing for email, text or phone message as proper notification to the Superintendent.

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