BGI Resources Comments to Proposed Revisions to 25 C.F.R. Part 226

Tara Righetti <TRighetti@bgina.com> Thu, Mar 28, 2013 at 6:23 PM
To: "Carr, Donald A." <donald.carr@pillsburylaw.com>, "osageregneg@bia.gov" <osageregneg@bia.gov>

Dear Mr. Streater,

On behalf of the Osage Negotiated Rule Making Committee, please accept the attached comments from BGI Resources, LLC on the proposed revisions to 25 C.F.R. Part 226. Please make these comments part of the official public record in this matter.

Your assistance in this manner is greatly appreciated.

Best regards,

Tara Righetti

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BGI Resources, LLC - Comments on Proposed Revisions to 25 C.F.R. Part 226.pdf
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BGI RESOURCES, LLC

March 28, 2013

Mr. Eddie Streater, Designated Federal Officer
Bureau of Indian Affairs, Wewoka Agency
P.O. Box 1540
Seminole, OK 74818
via email: osageregneg@bia.gov

Re: COMMENTS ON PROPOSED REVISIONS TO 25 C.F.R. § 226

Dear Mr. Streater and Members of the Osage Negotiated Rulemaking Committee:

BGI Resources, LLC ("BGI") submits these comments to the Osage Negotiated Rulemaking Committee (the "Committee") regarding its proposed revisions to regulations concerning the leasing of Osage Reservation lands for oil and gas mining, 25 C.F.R. Part 226. These comments focus specifically on the Committee's proposed revisions to the oil royalty payment provisions of 25 C.F.R. § 226.11(a), which call for a royalty calculation of 20 percent of the value of oil determined by the greater of (a) monthly average NYMEX pricing at Cushing or (b) the actual selling price. Additionally, BGI Resources submits its comments on other proposed revisions that pose both legal and practical concerns.

BGI signed a concession agreement with the Osage Nation (f/k/a/ the Osage Tribe of Indians of Oklahoma) (the "Tribe") effective May 17, 2006, which was duly approved, by the Osage Tribal Council and the BIA Osage Agency Superintendent (the "Concession Agreement"). On February 17th, 2011, BGI notified the Mineral Council and BIA Osage Agency that it was exercising its option to convert its concession into a Seismic Concession. The Concession Agreement runs through February 17, 2017 and authorizes BGI's exploration, leasing, and development of certain properties within a designated concession area on the Osage Reservation for the removal of oil and gas pursuant to leases with the Tribe upon pre-negotiated and pre-approved terms and conditions. The Concession Agreement expressly provides that "[e]ach Lease *shall* contain the *identical* terms and condition[s]" set forth in the Concession Agreement, and in the form lease attached thereto (emphasis added). Among the terms and conditions that must be included in BGI's leases is a royalty rate calculated as 3/16 of the gross proceeds from sales based on actual selling price, or the highest posted or offered price, whichever is higher. In other words, the Concession Agreement requires that leases between BGI and the Tribe contain a royalty calculation that is different from what the Committee is currently proposing in its revisions to Part 226.

It is our understanding the Concession Agreement, and the terms of subsequent leases entered thereunder, would remain unchanged by the Committee's proposed regulations, at least with respect to the royalty calculation. This is because the definition of "lease" at 25 C.F.R. § 226.1(d) was written to include concession agreements, and because 25 C.F.R. § 226.5 states that no amendment or change in the regulations made after lease approval (including approval of the Concession Agreement) shall operate to affect the established term or the royalty rate. In BGI's case, that would mean a continuing royalty calculation of 3/16 of the gross proceeds from sales based on actual selling price, or the highest posted or offered price, whichever is higher, through the term of the Concession Agreement and any leases acquired thereunder. Committee meeting comments have confirmed this understanding. *See* Committee staff member comment, Committee Meeting 3 (Oct. 22, 2012) at 11 ("the proposed changes that the Committee is discussing would not constitute an abrogation of leases").

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We are concerned, however, with comments made at the most recent Committee meeting which directly contradict the terms of the Concession Agreement, as well as the express language of the regulations. For example, a Committee representative stated that "existing royalty rates would not change" but commented that the "calculation of royalty payments on existing leases would be based on the NYMEX index." Committee representative comment, Committee Meeting 6 (Feb. 26-27, 2013) at 6.

Because these recent comments create an ambiguity, BGI asks that the Committee clarify the effect of the proposed Part 226 amendments on existing leases, including existing concession agreements. In BGI's Concession Agreement with the Tribe, the parties agreed to enter into leases with "identical terms and condition[s]" to those specified in the Concession Agreement, and in the form lease attached thereto. It is no answer that the Concession Agreement and leases were subject to subsequent regulatory changes, because 25 C.F.R. § 226.5 expressly provides that subsequent regulatory changes will not affect royalty rates. It would also be illogical for contract interpretation purposes, to contend that "royalty rate" should be defined only as a fraction, "3/16," without reference to the unit being measured: the gross proceeds from sales based on actual selling price, or the highest posted or offered price, whichever is higher.

Additionally, the regulations also purport to increase the annual rental from $2 per acre, as stated in BGI's leases and the form lease attached to BGI's Concession Agreement, to $20 per acre, an increase of 1,000%. The increase in rental does not serve to advance any proper governmental purpose of the BIA or Tribe, except to exact a higher economic benefit from the contract with BGI. BGI's Concession Agreement specifically provides that "changes in economic conditions or the potential production from the lands covered by each Lease shall not change the pre-negotiated and pre-approved terms and conditions of each such Lease, which terms and conditions are set forth on [the preapproved form of the lease]." The actual change in lease rentals, and the effective change in royalty rate, both purport to unilaterally change BGI Resources rights under the leases, despite the Committee's comments to the contrary.

In addition to the legal concerns articulated above, BGI asks that the committee consider some of the practical consequences of the current proposed changes in the regulations:

- 226.1B-1 allows the BIA to issue new NTLs which function as regulations but which does not require approval or consultation with the minerals council. This allows BIA to issue restrictions or changes of operations as an executive function, without going through congress OR the mineral council. This constitutes a massive expansion of federal authority, in a manner that no longer requires the cooperation, notice, or participation of the minerals council. Based on its experience in other federally managed areas, BGI can attest that NTLs, in addition to creating regulatory ambiguity, also serve to increase the cost, timing, and ability to efficiently explore for and produce oil, and function as regulations but without requiring the government to go through the procedural hurdles of the APA.
- Presently, the regulations distinguish between casinghead gas and natural gas. Casinghead gas is produced along with the oil in an oil well and is often produced in very small quantities. These quantities are small enough so that measurement, processing, and sale are neither practicable nor economic. If sold, the current leases provide that a royalty must be paid on casinghead gas. However, often this produced casinghead gas is unmarketable due to its large quantities of nitrogen and hydrogen sulfide, or its general low volume. In removing the distinction between casinghead gas and natural gas, the committee imposes regulations related to measurement (226.39 and 226.32), royalty (226.11(3)(b)), and avoidable loss (226.1(o)) on casinghead gas regardless of whether such gas is or would be able to be sold and including such gas produced during the testing and drilling of a well.
- BGI Resources Leases and the Lease attached to BGI Resources concession agreement, provide that a royalty of 3/16 is owed only on the "*value* of natural gas...extracted, produced, *and sold*" from the lease. The proposed changes to 226.11(3)(b) would materially and unilaterally change the terms of BGI's Concession Agreement and Leases so that the superintendent or minerals council could direct BGI to pay royalty on all gas, both casinghead and natural gas, removed from the lease, whether or not it was sold. Further, the regulations give the superintendent and minerals council unilateral and unbounded discretion to determine what the "value" of the

natural gas is, such determination which may have no bearing on the actual price (if any) received. Processing costs for the determination of value are capped at fifty (50%) by 226.11(3)(B)(2) even though actual processing may greatly exceed that percentage, perhaps even exceeding the value of the gas itself, if the superintendent did not grant approval for flaring or venting of unmarketable gas. Additionally, the exclusion of casinghead gas from the definition serves to expand the definition of Natural Gas under the lease. These regulations effectively serve to unilaterally change the definition of Royalty under the leases and BGI's Concession, so that it is calculated without regard to value or volume as understood at the time of contracting.

- The drafting of 226.9 as it relates to drainage raises several ambiguities and impractical results. As drafted, these provisions would impose offset drilling obligations on a lessee from its own wells on adjoining leases with the same mineral owner, potentially under 226.15 requiring it to merge or unitize its own wholly owned leases to avoid offset drilling obligations. This is an irrational result, and one that produces an administrative burden with no benefit. Currently the lease terms impose an offset drilling obligation *only* where Lessor (the Osage Tribe) is not the owner of the minerals on adjoining lands. This language is perfectly sufficient to protect the Osage from drainage and also does not promote arbitrary, unnecessary, and inefficient drilling and well spacing without any technical consideration of the actual utility of doing so.
- 226.18 and 226.19: Notice and the payment of commencement money to the surface owner should not be a condition of approving a drilling permit or surveying or staking the wells. Not all locations surveyed or staked, are permitted, and not all permits acquired are actually drilled. These provisions accordingly require commencement money for use of the surface on wells never drilled and where there is no surface disturbance. Additionally, the permitting process is already unduly long. To require a 30-day notice period to respond for a meeting 10 days prior to the commencement of staking or surveying, extends the permitting process a minimum of 40 days, even though no surface disturbance is required. Accordingly these provisions should only apply before the "commencement of *drilling* operations, site preparation, road grading, or graveling" to allow the oil and gas lessee to commence archeological and other surveying necessary as a pre-cursor to the permitting process.
- The inclusion of the term "All Spills" in 226.22A is unduly burdensome. Consider, for example, that when an operator pulls a well to replace a pump some amount of oil, however small, which coats or is within the tubing, drips onto the ground. These amounts are less than the minimum thresholds for reporting spills and protecting the environment in all existing environmental regulations, which do not even define crude oil as a pollutant. Is this a "spill" required to be reported to the Superintendent? This change effectively places more stringent environmental reporting restrictions within the Osage than the OPA, CWA, ESA, CERLA, and other federal environmental regulations already require in Osage County and on all other federally administered lands.
- 226.39 should be amended to read: "to the extent it conflicts with "other" provisions of these regulations, the "other provisions" of these regulations shall control."
- 226.1(o) The definition of "Avoidably Lost" should be amended so that the term marketable applies to both produced gas and other products. A minimum amount of mcf/d should be added to the definition to allow for the drilling and testing of wells.

Thank you for your time and attention to this important matter. If you have any questions, please contact me (TRighetti@Bgina.com) or Donald A. Carr, our legal counsel (donald.carr@pillsburylaw.com).

Please make these comments part of the official record in this matter. I also respectfully request that the committee address and clarify its position on these ambiguities at the Public Hearing on April 2nd.

Sincerely,

Tara Righetti

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