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## **GAS & OIL PPCs/THUNDER BAY NATIONAL MARINE SANCTUARY**

**House Bill 5709 as enrolled  
Public Act 441 of 2000  
Second Analysis (1-5-01)  
Sponsor: Rep. Larry De Vuyst**

**House Committee: Conservation and  
Outdoor Recreation  
Senate Committee: Natural Resources  
and Environmental Affairs**

### ***THE APPARENT PROBLEM:***

Landowners (including the state) may lease mineral interests in property to companies that explore for and extract the oil and gas deposits below the surface. Landowners receive rent and bonuses for the “purchase of the lease”, and royalties on any hydrocarbon production that occurs. The landowner’s royalty interest in the well is defined in a lease, and represents the landowner’s share of the hydrocarbon production, minus production expense. The Department of Natural Resources manages the state’s holdings and has written a state lease for leasing state-owned oil and gas minerals. Lease contracts that define agreements between oil and gas producers and private citizens may incorporate provisions of the state lease, but there is no requirement that the language of the state lease be used in private contracts. Lease contracts define payments, and royalty percentages, and provide for the deduction of certain postproduction costs (PPCs) that are applied against royalties.

In response to concerns from private landowners, the legislature in 1998 and 1999 added provisions to the Natural Resources and Environmental Protection Act governing lease arrangements involving the extraction of minerals. Among other things, the act specifies that a person who enters into a gas lease cannot deduct from the lessor’s (landowner’s) royalty any portion of postproduction costs unless the lease explicitly provides for such deductions. Further, if a lease explicitly provides for the deduction of postproduction costs, the lessee may only deduct for certain specified items (items that are listed in the statute, including the reasonable costs of removal of carbon dioxide, hydrogen sulfide, molecular nitrogen, or other substances whose removal will enhance the value of the gas, and certain specified transportation costs), unless the lease explicitly and specifically provides for the deduction of other items.

In addition, if a court finds that a lessee deducted postproduction costs from a lessor’s royalty in violation of the act’s requirements, a lessor may recover damages in the amount of wrongly deducted postproduction costs, and a party who prevails in litigation under this provision may recover reasonable attorney fees incurred in bringing an action, if the court finds that the position taken by the nonprevailing party was frivolous. Some people believe that requiring a landowner (the lessor) to prove that the oil or gas producer’s position is frivolous sets a standard for recovery of attorney fees that is too high.

In an unrelated matter, Governor John Engler and the National Oceanic and Atmospheric Administration (NOAA) announced on June 19, 2000 that an agreement had been reached on the designation of a national marine sanctuary -- the Thunder Bay National Marine Sanctuary and Underwater Preserve -- at Thunder Bay, Michigan. A five-year management plan adopted by the state and the NOAA proposes that the two entities jointly manage the new sanctuary and an existing state underwater preserve -- the Thunder Bay Great Lakes state bottomland preserve-- at the same site. The initial five-year period will provide an opportunity for both parties to determine the success of the partnership, after which the NOAA will re-propose the sanctuary/preserve, reflecting mutual concerns. The sanctuary will encompass 448 square miles of northwest Lake Huron off the northeast coast of Michigan’s Lower Peninsula, near Alpena. Its boundaries will surround the existing state underwater preserve. The NOAA agreed to the name, the Thunder Bay National Marine Sanctuary Underwater Preserve, to reflect the state underwater preserve. However, legislation is needed to extend the current boundaries of the state underwater preserve (whose area, by law, may not exceed 400 square miles) to approximate those

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of the marine sanctuary. Accordingly, legislation has been proposed to recognize these, and other provisions, of the mutual management agreement in statute. (See *Background Information* for additional information.)

### ***THE CONTENT OF THE BILL:***

The bill would amend the Natural Resources and Environmental Protection Act (NREPA) to rewrite the provision governing the awarding of attorney fees in actions involving wrongly deducted postproduction costs (PPCs); and to specify that the boundaries of the Thunder Bay underwater preserve and the Thunder Bay National Marine Sanctuary and Underwater Preserve would be the same, that it would be managed jointly by state and federal agencies, and to clarify that the state would retain ownership of these bottomlands should the area no longer be designated a national marine sanctuary after five years.

Endeavor to Cure Violation. The bill would specify that a lessor could recover reasonable attorney fees incurred in bringing an action to recover wrongly deducted postproduction costs, unless the lessee endeavored to cure the alleged violation before the court action was initiated, and that a lessee who prevailed in litigation could recover reasonable attorney fees incurred in defending an action brought under the provision if the court found that the lessor's action was frivolous.

Thunder Bay Marine Sanctuary. The bill would also amend provisions of the NREPA governing Great Lakes bottomlands to exclude the Thunder Bay Great Lakes State bottomland preserve from the provision which limits the total of the state's bottomland preserves to ten percent of all state Great Lakes' bottomlands, and an individual Great Lakes bottomlands preserve to 400 square miles in area. In addition, the bill would specify that the boundaries of the state's Thunder Bay preserve and the Thunder Bay National Marine Sanctuary and Underwater Preserve would be the same; that the right to explore, survey, excavate, and regulate abandoned property of historical or recreational value found on state land within the preserve's boundaries would be jointly managed and regulated by the Department of Environmental Quality (DEQ) and the National Oceanic and Atmospheric Administration as long as the Thunder Bay National Marine Sanctuary and Underwater Preserve remains a designated national marine sanctuary; but that these provisions could not be construed as conveying the ownership of such abandoned property from the state to the federal government.

MCL 324.61503b, 324.61503c, and 324.76111

### ***BACKGROUND INFORMATION:***

According to information on the National Oceanic and Atmospheric Administration's (NOAA) web site, the NOAA and the state reached agreement on designating Thunder Bay and the surrounding waters of Lake Huron as the thirteenth national marine sanctuary on June 19, 2000. However, members of the local community in Alpena had been interested in developing an underwater park since the early 1970s. Studies on the large number of shipwrecks in the area had led to the designation of Thunder Bay as one of the first state Great Lakes bottomland preserves in 1981. The preserve was established to protect bottomland and surface water areas containing abandoned property that was of cultural or recreational value. The NOAA, meanwhile, had been developing a Site Evaluation List (SEL) of potential candidates for designation as national marine sanctuaries. A group of Alpena residents submitted a proposal to the NOAA for the Thunder Bay National Marine Sanctuary, and, in 1983 the NOAA placed Thunder Bay on the final SEL.

In 1991, discussions began with Alpena residents, area divers, state agencies, and researchers regarding Thunder Bay, and the NOAA elevated Thunder Bay from the SEL to become an active candidate for national marine sanctuary designation. In October, 1991, the NOAA held public scoping meetings in Lansing and Alpena to learn more about the bay's resources, activities, and association management issues, and to share information as a national marine sanctuary candidate. Over the next three years, a series of informal working group meetings brought together local, state, federal, and tribal agencies, organizations, and businesses to discuss the scope of a National Marine Sanctuary in Thunder Bay.

In 1994, a Thunder Bay Core Group was formed, with members representing local, state, federal, and tribal agencies. The core group narrowed the management focus of a potential Thunder Bay National Marine Sanctuary to underwater cultural resources (e.g. shipwrecks). This recommended focus was presented and agreed upon at an Alpena community meeting in June, 1995. Management of natural resources was rejected by the core group in light of the fact that existing federal and state agencies were already managing these resources.

The core group recommended a Draft Environmental Impact State/Draft Management Plan (DEIS/DMP). This was published in 1997. Later that year, a Sanctuary Advisory Council (SAC) was established to provide the NOAA and the governor with

recommendations regarding issues of concern to the local communities. However, in November, 1997, the City of Alpena passed a referendum opposing the proposed sanctuary by 1,770 to 776 votes. This was a non-binding referendum that was used to inform the Alpena City Council about local sentiment regarding the sanctuary. At this point, NOAA decided to continue with the designation process, for several reasons. First, the NOAA still considered Thunder's Bay unique shipwreck collection to be of national historic significance, and thus an excellent candidate for National Marine Sanctuary designation. Second, the NOAA believed it could successfully address state and local concerns. Governor John Engler also encouraged the NOAA to continue working on the sanctuary proposal as long as state and local rights were protected.

Over the next year and one-half, the NOAA worked on drafting the "Final Environmental Impact Statement/Management Plan" (FEIS/MP), describing each party's responsibilities in the management of the sanctuary. The FEIS/MP was published in June, 1999. Among other things, it responded to public comments received on the draft Environmental Impact Statement/Draft Management Plan. In particular, NOAA made several changes to sanctuary regulations in order to make them more similar to Michigan laws. The state of Michigan released its own management plan for the sanctuary – the "Michigan Option" – in August, 1999. This plan recommended a state/federal partnership to manage shipwrecks in Thunder Bay, and suggested that the existing state underwater preserve and the new national marine sanctuary be managed jointly by the state and the NOAA.

### ***FISCAL IMPLICATIONS:***

The House Fiscal Agency (HFA) estimates that, if the project is developed in the manner contemplated under the bill, a recommendation would be forwarded to the legislature for consideration. (1-5-01)

### ***ARGUMENTS:***

#### ***For:***

The bill would clarify the attorney fee provision of the part of the NREPA that deals with litigation over postproduction costs. It would make the standard for recovering attorney fees easier for a landowner to meet, and it might have the effect of reducing litigation altogether, as it could encourage oil and gas companies to attempt to cure the disputed violation of the statute before litigation commenced. It has been pointed out

that most lessors are small landowners and have fewer resources for litigation than does a large corporation.

#### ***For:***

By encouraging companies to attempt to cure disputed deductions before any litigation occurred, the bill would improve a lessor's confidence in the leasing process and also the relationship between mineral rights owners and oil and gas companies. This would promote the state policy, expressed in the act, ". . . to foster the development of the industry . . . with a view to the ultimate recovery of the maximum production of these natural products" (MCL 324.61052). According to the Michigan Oil and Gas Association, Michigan is one of the nation's major sources of oil and gas, having produced more than a billion barrels of crude oil and over four trillion cubic feet of natural gas since the state's first commercial oil field was discovered in Saginaw in 1925. The association also reports that the industry has contributed more the \$550 million in oil and gas revenue from state-owned land and mineral rights to the Michigan Natural Resources Trust Fund since 1976. Clearly, the oil and gas industry is important to Michigan's economy, and it is important that developers and mineral owners have a good working relationship.

#### ***Against:***

The bill should go further. As introduced, it would have deleted language allowing for the deduction of postproduction costs other than those listed in the statute. This would provide further protection for landowners who must negotiate individually with companies. Mineral lease arrangements are often complex; it is possible for deductions for postproduction costs to *exceed* the royalty payments due to the landowners.

#### ***Response:***

The oil and gas industry opposes the broader change; it supports the right of parties to contract for royalties on any basis they choose, as long as the language is specific and explicit.

#### ***For:***

House Bill 5709 would simply incorporate the provisions of an agreement which was reached between the state and the National Oceanic and Atmospheric Administration (NOAA) on June 19, 2000. Specifically, the bill would stipulate that the state and the NOAA would jointly manage the existing state underwater preserve -- the Thunder Bay Great Lakes bottomland preserve -- and the new national marine sanctuary -- the Thunder Bay National Marine Sanctuary. In addition, the bill would clarify that the

boundaries of the Thunder Bay preserve and the national marine sanctuary would be the same, and clarify that the state would retain ownership of these bottomlands if, at some future date, the area should no longer be designated a national marine sanctuary.

Analyst: D. Martens/R. Young

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#This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.