



RICK SNYDER
GOVERNOR

STATE OF MICHIGAN
DEPARTMENT OF NATURAL RESOURCES & ENVIRONMENT
LANSING



UNDERGROUND NATURAL GAS STORAGE LEASING PROGRAM REPORT
for
FISCAL YEAR 2009-2010

AUTHORITY:

Part 5, Section 502, Act 451, Public Acts of 1994, as amended, authorizes the Department of Natural Resources and Environment (DNRE) to enter into contracts for the Underground Natural Gas Storage (UNGS) Leasing Program. The DNRE procedures for UNGS leases of state-owned lands, directs staff to continue to evaluate and review the program and provide an annual report. This Fiscal Year (FY) 2010 report covering activity from October 1, 2009 through September 30, 2010 was created by the Mineral and Land Management staff, Forest Management Division.

LEASE TERMS:

Terms of the state's lease for UNGS include a seven-year primary term and a rental rate commencing at \$7.50 per acre, per year for the first five years. The rental amount will be adjusted on each fifth-year anniversary date of the lease, based on the Consumer's Price Index for natural gas in Detroit.

There are 38,946 acres under 91 State UNGS Leases. Fifteen leases totaling 19,063 acres do not have an annual rental, as all monies were paid in advance for the longer-term leases.

DIRECT LEASES:

Fifteen new direct leases were issued in FY2010. The UNGS leasing procedures and lease form were updated and approved by the Director of the DNRE in FY2010. One application for a new storage field was received in FY2010. More applications are anticipated for FY2011.

EXTENSIONS:

No lease extensions were processed for FY2010.

ASSIGNMENTS:

There were no UNGS lease assignments in FY2010.

RELEASES:

No UNGS leases were released in FY2010, but one nomination was withdrawn in FY2010.

REVENUE AND DISTRIBUTION:

Revenue:

During FY2010, total income from UNGS activities on state lands was \$918,106. UNGS lease revenue typically includes the standard bonus and rent but does not include royalty payments. The liquid production royalty payments from the northern Guelph (Niagaran) reef trend leases are accounted for as part of the oil and gas lease revenue. This liquid production would otherwise not be recovered.

The following chart gives a historical overview of revenue received from this program.

REVENUE FROM UNDERGROUND NATURAL GAS STORAGE ACTIVITY

YEARS	ROYALTY (O&G program)	RENTAL	WELL SITE FEES	APPLICATION REVIEW FEES	BONUS	TOTAL INCOME	LEASED ACRES
2001	\$ 0*	\$50,336#	\$5,800#	\$ 0	\$ 0	\$ 56,136	26,690
2002	\$ 0**	\$ 30,953	\$ 1,900	\$ 4,223	\$ 5,777	\$ 42,853	27,783@
2003	\$ 21,689	\$ 50,428	\$ 4,300	\$ 14,251	\$ 30,850	\$ 121,518	29,376
2004	\$ 148,243^	\$ 42,252	\$ 3,200	\$ 1,370	\$ 0	\$ 195,065	31,132@
2005	\$ 24,509	\$ 65,429	\$ 3,900	\$ 0	\$ 3,640	\$ 97,478	31,412
2006	\$ 41,639	\$ 59,163	\$ 3,300	\$ 19,325	\$ 0	\$ 123,427	31,331
2007	\$ 32,179	\$ 70,585	\$ 3,800	\$ 78,286	\$ 66,842	\$ 251,692	32,053
2008	\$ 907,732	\$ 72,984	\$ 3,800	\$ 26,282	\$ 36,000	\$1,046,798	32,610
2009	\$ 104,564	\$ 81,445	\$ 4,300	\$ 10,960	\$ 0	\$ 201,269	32,490
2010	\$ 469,537	\$120,662	\$ 2,400	\$ 2,720	\$322,787	\$ 918,106	38,946
TOTALS	\$1,750,092	\$644,237	\$36,700	\$157,417	\$465,896	\$3,054,342	

* The royalty payments were not made because of the acquisition of the UNGS fields by another company, which was not aware of the payments. The new company was notified and payment was a credit.

* Additional royalty payments were expected in FY 2002, but were not received.

Rentals and Well Site Fees were received in advance of normal payment schedule as the company was changing systems and did not want to miss the payment date.

@ Leased acres increased due to additional parcels found to be under lease.

^ A settlement was reached on liquid production from Blue Lake 18A Field.

ROYALTY:

Current royalty amounts are from northern Guelph (Niagaran) reefs because of the cyclic underground gas storage operations produce quantities of liquid hydrocarbons. This production is similar to what is produced during secondary recovery or pressure maintenance operations. Without the reinjection of the natural gas during storage operations, most of this liquid production may never have been brought to the surface. As mentioned previously, royalty payments are accounted for under the oil and gas lease program.

During FY2002 an additional northern Guelph (Niagaran) reef UNGS field was identified to have liquid production where state lands were under lease. A settlement for Blue Lake 18A Field was agreed to in FY2004 and payment was made for current and back production. In FY2008, the remaining gas in place for the Coldsprings 1 Field was received.

LEASE AUDITING:

The DNRE has not contracted for independent audits for the UNGS program since the primary lease revenue is limited to bonus and rent. Review of bonus and rent payments is currently completed by in-house staff. If royalty revenue significantly increases, the DNRE could complete a cost/benefit analysis to determine if an audit would be appropriate under the oil and gas program.

Overall Summary:

	Number of Company Audits	Number of Units Audited	Amount Due to the State	Amount Currently Collected	Amount Refunded to Company	Refund Savings Resulting from Audit Disallowances	Contract Costs Where Settlement has Occurred
Settled Audits	None						
Pending Audits	None						

DISTRIBUTION:

Revenue involving bonus and rent received from the UNGS leasing program is primarily deposited into the General Fund since the leasing is considered a surface right. Revenue associated with those parcels acquired with federal funding such as Pittman-Robertson, and Dingell-Johnson is deposited into applicable funds. Processing fees, also known as application review fees, are deposited into the Forest Land User Fund.

In FY2010, 98.84 percent of the bonus and rent received from the UNGS leases was deposited into the General Fund. The Pittman-Robertson and Dingell-Johnson Funds received the remaining 1.16 percent.

LEASING POTENTIAL:

There is potential for additional interest in the Guelph (Niagaran) reef trends for UNGS in nearly depleted oil and gas producing fields. These reefs make excellent gas storage reservoirs because their height increases the volume of gas that can be stored per surface acre, as compared to the thinner Michigan Stray Sand rock formation gas storage fields. Several non-development leases have been issued recently to complete existing UNGS fields. Nine applications for new UNGS Fields were received in FY2007, six in FY2008, one in FY2009 and FY2010 and more are expected in FY2011. This potential, as well as the increased demand during winter months, has increased our expectations there may be additional UNGS leases applied for, and negotiated in the future.

LEASING ISSUES:

The UNGS lease and leasing procedures were reviewed, updated, and approved by the Director of the DNRE in FY2010.