North Dakota Legislative Management
Meeting Minutes
23.5122.03000

ENERGY DEVELOPMENT AND TRANSMISSION COMMITTEE

Tuesday, March 1, 2022
Roughrider Room, State Capitol
Bismarck, North Dakota

Senator Jessica Bell, Chairman, called the meeting to order at 9:00 a.m.

Members present: Senators Jessica Bell, Brad Bekkedahl, Kathy Hogan, Curt Kreun*, Dale Patten, Merrill Piepkorn; Representatives Tracy Boe, Mike Brandenburg, Alisa Mitskog*, Todd Porter

Members absent: Representatives Dick Anderson, Don Vigesaa

Others present: Senators Donald Schaible, Mott, and Rich Wardner, Dickinson, and Representative Jim Schmidt, Huff, members of the Legislative Management
See Appendix A for additional persons present.
**Attended remotely*

It was moved by Senator Hogan, seconded by Representative Brandenburg, and carried on a voice vote that the minutes of the August 4-5, 2021, meeting be approved as distributed.

PIPELINE AUTHORITY

Mr. Justin Kringstad, Director, North Dakota Pipeline Authority, presented testimony (Appendix B) regarding North Dakota's natural gas production, processing, transmission outlook, and energy corridors.

DEPARTMENT OF COMMERCE

Mr. Josh Teigen, Director, Economic Development and Finance, Department of Commerce, presented testimony (Appendix C) regarding support of a west to east natural gas pipeline for economic development.

POSTPRODUCTION DEDUCTIONS

Background

Mr. Christopher S. Joseph, Counsel, Legislative Council, presented a memorandum entitled *Oil and Gas Lease Postproduction Deductions - Background Memorandum* regarding the committee's study of deductions for postproduction costs under oil and gas leases. He noted:

- In North Dakota, royalties due to mineral owners for the production and sale of oil and gas is governed by contract law, meaning the express oil and gas lease contract entered between the mineral owner and the lessee.
- Most royalty clause provisions provide royalties due to the mineral owner are determined based on the value of the gas "at the mouth of the well" or "the market value at the well." This is because in *Bice v. Petro-Hunt, L.L.C.*, 2009 ND 124, the North Dakota Supreme Court joined the majority of states following the "at the well" rule for calculating royalties on oil and gas leases.
- States can be divided into two categories--those that follow the at-the-well rule and those that follow the marketable-product rule. Under the marketable-product rule, lessees impliedly covenant to bear the costs of getting gas into marketable condition and transporting it to market.

Petroleum Council

Mr. Ron Ness, President, North Dakota Petroleum Council, presented an overview, (Appendix D) of the complexities and challenges of Bakken oil and gas development, and environmental, social, and governance standards. He noted the Legislative Council staff may want to provide the committee with an analysis of the recent

North Dakota Supreme Court case of *Blasi v. Bruin E&P Partners, et al.*, 2021 ND 86, relating to the valuation point of oil for purposes of determining royalties due to a mineral owner.

Chairman Bell requested the Legislative Council staff distribute a memorandum entitled *Determining Royalties: The Valuation Point of Oil; A Case Study Analysis of Blasi v. Bruin E&P Partners (2021 ND 86)* to the committee.

Hess Corporation

Mr. Brent Lohnes, General Manager, North Dakota Operations, Hess Corporation, presented testimony (Appendix E) regarding deductions for postproduction costs under oil and gas leases. He noted:

- Since 2014, Hess Corporation has paid over $2.3 billion to royalty owners, and royalty payments are paid pursuant to approximately 20,000 oil and gas leases.
- Over 90 percent of royalty value comes from oil sales.
- Since 2014, Hess Midstream has invested over $2 billion in midstream infrastructure, including the Tioga gas plant, the LM4 gas plant, 1,350 miles of gas and natural gas liquids gathering, and 550 miles of oil gathering pipelines.

The committee discussed the reasons mineral owners may agree to enter oil and gas leases and how such leases are governed.

Mr. Lohnes noted the lease governs the relationship between the royalty owner and working interest owner for as long as oil and gas is produced and the operator of a unit pays royalties in accordance with the terms of the lease. He noted a royalty owner negotiates the lease to secure benefits, including an upfront per acre signing bonus to enter the lease, the royalty percentage, the point of valuation, and prohibited deductions.

National Association of Royalty Owners

Mr. Russell Murphy, President, North Dakota Chapter, National Association of Royalty Owners, presented testimony (Appendix F) regarding postproduction deductions. He noted:

- Postproduction deductions from oil and gas leases are difficult to understand and can account for a large value deduction of the royalty payment.
- Oil and gas producers are for-profit businesses and need to make a profit to continue to conduct business, but it is not uncommon to see gathering, drying, compression, and transportation deductions of over 80 percent of the gas royalty.
- Using the "comparable sales method" would be the most fair method to calculate the value of oil and gas.
- Using the valuations of an unrelated party could reduce the abusive overassessment of deductions used when a related party is marketing the lessee-produced gas.

Williston Basin Royalty Owners Association

Mr. Robert Skarphol, Founder, Williston Basin Royalty Owners Association, presented testimony (Appendix G) regarding postproduction costs assessed and collected.

Department of Mineral Resources

Mr. Lynn Helms, Director, Department of Mineral Resources, presented testimony (Appendix H) regarding deductions for postproduction costs under oil and gas leases. He noted:

- Royalties are paid on the value of the oil and gas at the well site, which is the first point of custody transfer.
- For oil, the value at the well site is the gross value minus transportation costs associated with moving the oil from the well site to the point of sale under the first arms-length contract.
- For gas, the value at the well site is the gross value minus transportation costs associated with making the gas and natural gas liquids marketable and moving the gas and natural gas liquids from the well site to the point of sale under the first arms-length contract.

Department of Trust Lands

Ms. Jodi A. Smith, Commissioner, Department of Trust Lands, presented testimony (Appendix I) on behalf of the Board of University and School Lands and the Attorney General's office regarding postproduction costs as it relates to the Board of University and School Lands' lease.

Public Comment and Committee Discussion

Ms. Naomi Staruch, mineral owner, McKenzie County, provided testimony (Appendix J) regarding postproduction deductions and royalties.

Mr. Neil Christensen, Surface and Mineral Agent, Jamestown, provided testimony (Appendix K) regarding Senate Bill No. 2217 (2021) and postproduction cost deductions.

Ms. Kate Black, Vice President, Inland Oil & Gas, Bismarck, provided testimony (Appendix L) regarding oil and gas leases entered between mineral owners and operators.

Mr. Shane Leverenz, land and mineral owner, North Dakota, presented testimony (Appendix M) regarding postproduction deductions and royalty payments. He noted:

- Since 2015, some of his postproduction deductions have exceeded his royalty payments for gas, meaning he paid the company instead of the company paying him.
- He has to pay $53.55 for an Excel file showing a copy of his revenue statement from Hess Bakken Investments.
- Actions the state can take to help mineral owners include prohibiting lease-line allocation wells, maintaining a list of valid mailing addresses for oil companies on the Department of Mineral Resources' website, establishing a penalty for an oil company that does not provide a mineral owner with a response within 30 days as required under North Dakota Administrative Code Section 43-02-06-01(12), and prohibiting postproduction deductions unless a lease specifically allows for the deductions.

The committee discussed the Legislative Assembly's ability to restrict or regulate oil and gas lease terms and whether any newly enacted statutory regulations could have retroactive application.

Mr. Joseph noted both the federal and state constitutions limit the power of the state to impair or modify contract rights. He noted:

- Courts generally are reluctant to uphold statutes that impair or interfere with existing contracts retroactively due to the inherent principle of a party's right to enter contracts freely.
- Section 18 of Article I of the Constitution of North Dakota prohibits a law impairing contracts.
- When determining whether a state law passes muster under the Contract Clause, the threshold issue is whether the state law has operated as a substantial impairment of a contractual relationship. If the law operates as a substantial impairment, the question becomes whether the state law is drafted in an appropriate and reasonable way to advance a significant and legitimate public purpose. The state would bear the burden of proof in showing a significant and legitimate public purpose underlying the act.

No further business appearing, Chairman Bell adjourned the meeting at 2:45 p.m.

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Christopher S. Joseph
Counsel

ATTACH:13