Senate Bill 2217
Testimony of Gary Hagen, North Dakota Mineral Owner
March 15, 2021

My name is Gary Hagen and my family owns mineral rights in McKenzie County, North Dakota. I come before you to testify in favor of the original version of SB2217 as submitted by Senator Brad Bekkedahl.

Historically, the percentage of our gas royalties deducted as post-production expenses averaged in the mid-forties. Then between January 2019 and July 2019, the deduction amounts jumped from 46.54% to 105.83%, more than doubling in a seven month period. Since then, virtually all of our gas royalties have been taken through post-deduction "processing fees" or "service fees". In some months where the fees exceed 100% of the gas royalties, the oil company takes further deductions from our oil royalties to cover the "losses" that they claim to sustain from the gas operations.

Every testimony from the oil industry lobby in opposition to SB2217 contains some variation on the theme of "we invested a lot of money in North Dakota blah blah blah but if you don't let us stick the mineral owners as much as we want, we might take our ball and go home, the state will receive less in tax revenues and everyone loses. We are enhancing the value of the gas by selling it farther downstream so the mineral owner benefits, etc."

From a mineral owner's point of view, if we already receive nothing for our gas royalties because the oil company offsets all of the revenues with post-production expenses, and they continue to take it all even if they get a higher price by laundering the sales farther downstream through a third party/Master Limited Partnership scheme, then what benefit did we the owners really receive? Sure, the oil company made more money on the deal but our net income is still nothing. The company gets to avoid the arms-length transaction laws and may also receive profitable kickbacks in various other forms such as ownership of pipeline shares.

The oil executives say that the mineral owners have an obligation to "share" in the costs. Sharing implies a mutual benefit or a mutual shouldering of a burden. It isn't sharing when we are forced to give up all of our asset to cover their costs, but we don't share in the profits. They are taking most or all of the money they made from selling the gas and sometimes garnishing the oil royalties on top of that. Without an audit, who knows if some that money is really paying for infrastructure expenses or marketing blunders or geopolitical risks or other costs of doing business that have nothing to do with transporting and marketing the product?

The lobbyists further claim that it is okay for them to do what they are doing because the leases are contracts that were entered into freely and in good faith by both parties. I guess they forgot the part of the contract where the lessee agreed to take on the cost of developing and marketing the resource in exchange for 80% or more of the production. The leases don't say that the lessee agrees to 80% but feel free to come back years later and take more, because you think you can and there aren't any laws to stop you.
Additionally, I would argue that a lease contract isn't negotiated in good faith when an oil company or a landman knowingly offers a lease that is written in impenetrable legalese and heavily loaded with clauses in favor of the lessee. Ten to fifteen years ago when the majority of the privately owned acreages were leased, the normal industry practice was to acquire the acreage at the most lowball price possible and then drill a single well to hold it all by production. If the mineral owner didn't know what

a Pugh clause is, too bad. If the mineral owner "trusted the landman" to give them a fair deal, only to find out later that the landman may have lied, made verbal promises that were not included in the lease document, or otherwise cheated them on the lease terms, too bad.
If the drilling unit was force pooled and unitized, so the mineral owner felt forced to sign a bad lease because the only alternative under North Dakota law is to sell the minerals or become a non-consenting co-tenant, too bad.

The oil companies deliberately took advantage of a lot of people and the State let them do it because the State wanted the money. Good faith and fair dealing were rarely part of the relationship, at least in my experience and that of every mineral owner I have ever met.

Even today, the county courthouses are recording new leases containing detailed language that allows the deduction of post-production costs. How many of the people who are signing those leases understand what it means or take the time to run it by an expensive oil and gas attorney? Do the landmen helpfully explain to them that by the way, this clause here means you get nothing for your gas royalties plus we can eat up your oil royalties too?

So I ask:
Why should an oil company have the exclusive right to decide that extra deductions are "permitted" by a lease, only because they were not specifically denied by the lease?

As some of you may know, the North Dakota Supreme Court in Newfield Exploration Co. v. State of North Dakota, et al., (2019 ND 193, July 11, 2019) held that royalties were illegally deducted using post-production deductions based on net vs gross proceeds, concluding that
"Gross proceeds from which the royalty payments under the leases are calculated may not be reduced by an amount that either directly or indirectly accounts for post-production costs incurred to make the gas marketable."

Of course these days, even Supreme Court decisions may not be final. It seems like there is always some technicality or angle that was not specifically addressed in the court opinion, that requires the case to be reheard. In the meantime, the oil companies (or the State) get to keep all the money. Unfortunately, mineral owners don't have the unlimited resources enjoyed by the State and the oil lobby when it comes to legal costs. That is why we need a new law that protects us with detailed, unambiguous language as proposed in the original version of SB2217. We also need the right to audit where the gas was sold and under what terms, so they can't hide the shell games.

I am very disappointed that the Senate Finance and Taxation committee completely gutted the SB2217 bill and replaced it with a call for a study. That action, or lack of action, is nothing but a green light for the oil companies to go ahead with business as usual.

As one of the hundreds of mineral owners who had their mineral rights stolen by the State of North Dakota's "Ordinary High Watermark" (OHWM) scam, I don't have much faith in studies as a legitimate problem-solving tool, particularly when the real purpose of the study is to stall for time or to justify theft, as was done with the Bartlett/West and Wenck studies. Eleven years later, the State is still enjoying the benefit of using hundreds of millions of dollars in stolen royalties as an interest-free loan, while the lawsuits and studies go on forever.

In one of these failed lawsuits, the Sorum/Nelson case (which also sought to steal all of my mineral rights and give them to the State), Justice Tufte wrote in the Supreme Court opinion that "The State has a moral obligation to deal fairly with the people". I submit to you that the legislature also has a moral obligation to own up to its failures of the past and stop running away in a blind panic every time the Petroleum Council threatens to take away your magic money trough. We the people who actually own the minerals that you tax at thirteen percent right off the top without our consent, have a right to be represented too.

In closing, I request that SB2217 be restored in its original form and built upon with specific language that legally codifies what post-production deductions are or are not allowed.

Thank you for this opportunity to testify.