

Testimony in Opposition to
SENATE BILL NO. 2217
Senate Finance and Taxation Committee
February 8, 2021

Chairman Bell and Senate Finance and Taxation Committee members, my name is Holly Camilli. I am a Vice President of XTO Energy Inc., responsible for development and operations in the Bakken, Argentina, and the Central United States. XTO currently operates approximately 463,000 acres of oil and gas development in North Dakota and safely and responsibly produces approximately 75,000 barrels of oil and 192 million cubic feet of gas per day. I write the committee today in opposition of SB 2217, which would fundamentally reverse the manner in which post-production costs are treated under North Dakota law, to the detriment of producers and royalty owners alike.

The bill would dramatically disrupt the settled expectations and understanding about the meaning and requirements of existing leases – leases that were negotiated in good faith by both producers and royalty owners based on well-understood principles of North Dakota law. Retroactively changing the meaning and requirements of those leases is neither warranted nor good policy.

For decades, the common requirement in oil and gas leases that royalty be calculated “at the well” has been understood to allow for post-production deductions from royalty. The royalty owner receives their negotiated share of production valued at the point of production – the wellhead. When the value of that production is enhanced - to the benefit of both the producer and the royalty owner - by selling it downstream of the wellhead, the expectation of all parties has been that the royalty owner would share in those post-production expenses. This foundational premise of royalty law has been confirmed by the North Dakota Supreme Court in the *Bice* and *Kittleson* decisions and relied upon by producers when making decisions to purchase leases, drill wells, and market the hydrocarbons. If a lessor did not want post-production deductions, they have always been free to negotiate for “no deductions” language in the royalty clause.

Thousands of leases have been negotiated based on the well-understood fact that royalty owners would bear post-production expenses unless the lease specifically stated otherwise.

Senate Bill 2217 would reverse this basic understanding, requiring that leases explicitly allow for post-production deductions or they cannot be deducted. Even more troublingly, it would operate *retroactively*: turning upside down the long-standing economic assumptions upon which exploration and production decisions have been made. Legislatively changing the terms of a contract after negotiation effectively deprives both parties of the benefit of their bargain, impairing the value of decades of contracts negotiated in good faith. It would also change the economic analysis producers made when entering into new leases.

Annually, XTO remits over \$110 million in royalties to private leaseholders for production from the State of North Dakota, with approximately \$30 million in post-production deductions. Those post-production deductions represent transport, processing, gathering, and other charges incurred after production and after the point at which the royalty owners agreed to value their share of production. These charges are incurred in order to secure a sale at the best price available for both producer and royalty owner. The royalty owner shares in those additional costs, but also benefits from the increased value of the product. Without the ability to share costs via post-production deductions, producers are incentivized to make sales closer to the wellhead in order to minimize their costs, reducing the value received by royalty owners. As written, the bill negatively impacts the economic viability of the North Dakota Bakken resource compared to other producing basins in the United States and around the world.

The audit right created in SB 2217, which would now become a matter of criminal penalty, is neither necessary nor appropriate. The North Dakota check stub statute requires that specific information be provided to royalty owners with monthly payments, including the amount of deductions taken. N.D. Admin. Code § 43-02-06-01. The royalty owner may request additional information and direct questions to the producer via certified mail with an answer required within thirty days of receipt. In addition, royalty owners already have the right to inspect and copy royalty payment records of their lessees. N.D. Cent. Code Ann. § 47-16.39.2. These provisions address the same issues as the audit right proposed by SB 2217, but

without introducing additional ambiguity in the process, let alone making it a matter of criminal penalty. Royalties are a matter of contract, not criminal law. It is wholly inappropriate for a royalty accounting issue to result in criminal charges, such the class B misdemeanor requested within SB 2217.

Adopting SB 2217 would reverse years of North Dakota oil and gas law and up-end the understanding with which producers entered into oil and gas leases. Even if applied only prospectively, it would disadvantage royalty owners by discouraging producers from incurring costs to transport, process, and market products. Instead of being a leader, North Dakota would be an outlier amongst major oil and gas producing states.

In conclusion, XTO urges your opposition to SB 2217 and respectfully requests a Do Not Pass recommendation.