SENATE BILL 2374
Testimony of Craig C. Smith
Senate Energy and Natural Resources Committee

- February 9, 2023 -

Chairman Patten and members of the Senate Energy and Natural Resources Committee, for the record, my name is Craig Smith, I am an attorney with the law firm of Crowley Fleck, Bismarck, ND and have been with the firm since 1988, practicing exclusively in oil and gas law for the past 34 years. I am appearing before you in my capacity as an oil and as attorney and on behalf of the North Dakota Petroleum Council.

I believe it is fair to say the public is quite familiar with oil and gas development in North Dakota by now--specifically as it relates to the general knowledge of oil and gas drilling rigs, horizontal well and fracing technology, oil and gas pipelines, gas processing plants and so forth. However, one area that is often taken for granted in oil and gas development is the complexity of oil and gas title and ownership issues, all of which must be addressed before, during and after drilling and production operations occur. The complexity of title ownership issues is directly relevant to many of the proposed changes to existing royalty information statement laws and new penalties as proposed in SB 2374. I would like to take the opportunity today to address some of the specific provisions in SB 2374, but first I would like to provide some general background for the Committee relating to the title complexity issues.

I. TITLE EXAMINATION:

The typical abstract and surface title opinion for an agricultural parcel of property can take a matter of hours to prepare and cost in the hundreds of dollars. Abstracts are usually a couple hundred pages or less, title opinions 7-10 pages. Not so with oil and gas abstracts and title opinions. At the beginning of my career in the late 1980s, most wells were drilled on 80, 160 or 320 acre spacing units. Abstracts were 300-2000 pages long, and oil and gas title opinions took only a few days or a couple weeks to complete. However, over the last few decades mineral title has become extremely fractured. Today's Bakken spacing units are much

larger and typically consist of 1280 acres or 2560 acres. In my experience, today, the abstracts range from 10,000 pages to 140,000 pages (or 58 Banker's boxes containing 2,500 pages each) and the completed title opinions may range between 200 pages and 1,000 pages long and will take anywhere from three months to a year to prepare a single title opinion.

Due to the title complexity, Operators typically must plan their drilling schedules anywhere from 6 months to a year or more ahead of drilling recognizing that just the title ownership review timeline will take a couple months to prepare the abstract, four or more months for the title opinion to be prepared, and two months to incorporate the title opinion data into their internal Land and Division Order records software programs. The costs of the abstracts and title opinions frequently exceed $200,000 for each spacing unit, sometimes far in excess of that amount, which costs are borne entirely by the Operator and its working interest partners.

What type of information is shown or required by Operators in the typical oil and gas title opinion? The title opinion schedules show all owners of the surface tracts, all mineral and royalty owners and their respective oil and gas leases, overriding royalty owners, assignments of leases, the identity and percentage of the working interest owners, easements, and mortgages affecting all interest owners. The schedules will include the net mineral acres owned by each mineral owner, and the corresponding eight decimal figure owned by each owner, which information is currently required by NDIC Administrative Rule and used by the company to notify the mineral owners of the interest we believe they own. For example, our division of interest for a mineral owner who owns 40 net mineral acres in a 1280 acre spacing unit and subject to a 3/16 royalty clause in its oil and gas lease would show:

Mineral Owner "A"

40/1280 x 3/16 = .00585938 Net Acres: 40.000000

The title opinion will also set forth any title defects that affect all owners. If there are 150 mineral owners in a spacing unit, it can vary widely, but anywhere from 5-10% or 50% or more of the mineral owners may have title defects which require title curative measures prior to

releasing production proceeds. Title defects can be anything from conflicts or errors in mineral deeds, to the lack of probate proceedings and proper identity of the rightful heirs. The title opinion also designates those owners who do not have title defects and who may be placed immediately in pay status by the Operator.

Once the Company receives the final title opinion and the well(s) is being drilled or completed, the Company's Land and Division Order departments are incorporating the opinion's ownership information into their software programs. Obviously, given the 18% late payment statute, priority is given to place all mineral owners without title defects into pay status within the first 150 days of any sale of production. Attention is then focused on title curative and working with mineral owners on obtaining proper title curative, which can be as simple as obtaining an Affidavit of Identity on name variances, to as complex as the necessity of quiet title litigation to resolve a title conflict between mineral owners themselves.

After a well has been completed and the initial ownership has been set up in the system, title is not frozen in time. Transfers of mineral ownership, working interest ownership, and overriding royalties continue to change throughout the life of the well and the Company must continually update their internal pay records as these transfers take place going forward.

What type of information is *not shown* in a title opinion? While the opinion does show each mineral owner, their net mineral acres, oil and gas lease, and decimal interest in the well, we do not set forth the complete title chain for each mineral owner. In other words, we do not prepare schedules that would show, for each owner, every deed or conveyance relating to that specific mineral owner. In reviewing a 60,000 page abstract, to prepare such schedules for each of the 150 owners would increase the time and costs by indefinable amounts.

II. TITLE RELATED ROYALTY OWNER INQUIRIES:

The complexity of and the number of title related inquiries can vary widely. Some inquiries are very straight forward and can easily be resolved within 30 days, such as a simple inquiry as to "how did you calculate my 8 decimal number interest?" and the mineral owner

owns 40 acres under one lease as in the example I discussed above. Other inquiries may be much more complex, where the mineral owner disputes the number of acres owned, or where there are serious title defects requiring attorney consultation. In addition to complexity affecting a Company's response time to inquiries, the number of and the timing of inquires also varies greatly throughout any given year. As an example, where a company has completed a four well drilling pad and then sends out 300 division orders at the same time to all of the owners in these four new producing wells, the company may be inundated over a very brief time period with a large number of inquiries not only from mineral owners, but other interest owners in the wells including overriding royalty and working interest owners. On the other hand, there may be days or weeks where there are very few inquiries. In any event, the number and timing of inquiries also impacts the response time in addition to title complexity issues.

III. ANALYSIS OF SOME OF THE KEY PROVISIONS OF SB 2374:

Now, turning to the Bill itself, I have a few comments on some of the key provisions:

1) Page 1: Lines 9 and 10: Section 1: The commission may not determine the legal relationship between a lessor and a lessee or enforce lease terms or division orders.

COMMENTS: The proposed amendment as drafted is overly broad and should be deleted. The Commission, through its regulatory powers, often exercises its jurisdiction relative to spacing, pooling, flaring and other matters. The fact is, the Commission's orders may directly or indirectly affect lessors and lessees and their "legal relationships". However, in my career, the NDIC has never asserted jurisdiction over contractual lease provision disputes between lessors and lessees such as title disputes or interpretation of lease termination issues. As proposed, this language could be interpreted such that any mineral owner, or an operator for that matter, if dissatisfied with the NDIC could assert the particular matter relates to lessor/lessee legal relationship and the NDIC does not have regulatory jurisdiction.

2) Page 1: Lines 16-18. Section 38-06-06.3 Information Statement to accompany payment to royalty owner. Proposed amendment *requires* that in addition to the currently

required royalty statement information, the operator/payor must provide "a portable document format and comma-separated values file which are unlocked and editable by the recipient free of charge"

This proposed amendment has resulted in extensive comments and opposition from Company members, including but not limited to the following:

1) Statutes and NDIC regulations recently adopted already provide highly detailed information which must be provided with royalty payments, an undertaking that took over two years with input from both industry and royalty owners, and was at a significant financial cost to industry with major software upgrades;

(2) Many Bakken operators have 7,000 or more mineral owners just in their North Dakota databases. Providing additional electronic data for each royalty owner and on a monthly basis will be incredibly burdensome and costly,

3) Most companies' software programs are not designed to easily provide electronic data, such as Excel format.

(4) many royalty owners do not prefer royalty information via electronic means and in fact prefer that confidential financial information not be sent to their email accounts, yet this proposal would mandate electronic data be sent;

(5) providing "unlocked" accounting detail could lead to abuse and confusion creating issues with original version control;

(6) electronic data files can be extremely large and rejected by typical email servers. Are companies liable for penalties if the mineral owner changes email address, or the email server rejects the email?

(7) Smaller operators in the Williston Basin often contract with third-party purchasers to handle royalty payment and check detail requirements. This excess burden of mandatory monthly electronic data requirements may not even be realistically possible to comply.

(8) Electronic data files in Excel format are already available to mineral owners (and working interest owners) through a third-party vendor, EnergyLink. See www.energylink.com.

3) Page 2: Lines 1-3. Section 38-08-06.3(3). Information Statement to accompany payment to royalty owner. Adds the following information on the royalty statements: "The name, address, telephone number, electronic mail address, and, if available, facsimile number of the oil and gas operator and its designee must be made available by the operator or designee to the industrial commission."

COMMENTS: Operators are already required to provide contact information on Royalty statements:

ND Admin Code Section 43-02-06-01.1(12) provides: "An address where additional information may be obtained and any questions answered. If information is requested by certified mail, the answer must be mailed by certified mail within thirty days of receipt of the request."

To the extent this proposed amendment adds additional contact info such as a contact name and email addresses, we believe this type of additional information would be best handled through the proposed Royalty Owner Ombudsman Program proposed in Senate Bill 2194--more discussion on that later.

4) **Page 2, Lines 13-19. Section 38-08-06.6(1)- Ownership Interest Information Statement**: Proposed Amendment: Within one hundred twenty days after the end of the month of the first sale of production from a well or change in the spacing unit of a well or a decimal interest in a mineral owner, the operator or payor shall provide the mineral owner with a statement identifying the spacing unit for the well, and the effective date of the spacing unit change or decimal interest change if applicable, the net mineral acres owned by the mineral owner, the gross mineral acres in the spacing unit, and the mineral owner's decimal interest that will be applied to the well.

COMMENTS: This entire provision is duplicative of existing law and is unnecessary. This provision is already contained-word for word-in ND Administrative Code Section 43-02-06-01.1 and codifying the regulation may deprive the NDIC flexibility to make future adjustments through rulemaking.

5) **Page 2, Lines 20-28. Section 38-08-06.6(2) Ownership Interest Information Statement**: Proposed Amendment: An address provided under section 38 - 08 - 06.3 also must provide where additional information may be obtained regarding how the operator or payor has calculated the mineral owner's decimal interest and for any questions pertaining to the information provided on the statement. Upon request of the mineral owner, ***the operator, payor, or the operator's or payor's agent must provide the relevant document number or book and page number of any recorded document and the county in which it was recorded which relates to the owner's decimal interest. If information is requested by certified mail, the answer must be mailed by certified mail within thirty days of receipt of the request*** (emphasis added).

COMMENTS: Company members strongly oppose lines 23-28 requiring the furnishing of potentially limitless title information. In the event of a title dispute or if a mineral owner's interest has a title defect requiring payment suspense, current law, NDCC Section 47-16-39.4, already requires an operator to provide certain title information:

"[t]he mineral developer shall furnish the mineral owner with a description of the conflict and the proposed resolution or with that portion of the title opinion that concerns the disputed interest."

This proposed amendment greatly expands the requirements of Section 47-16-39.4 and should be deleted. There is no limitation in the amendment of what the operator must provide, and the amendment can be interpreted that the operator must provide the complete list of all possible documents from the abstract of title literally from the issuance of original government patent to all documents recorded subsequent relating to the mineral owner's interest. As previously testified, oil and gas abstracts are often tens of thousands of pages, title opinions do not include a schedule of all mineral owner transfers in the chain of title for each royalty or mineral interest, and to do so would be cost prohibitive and delay review of title and implementation of royalty payments. There would be an increased risk of being materially late and triggering penalties if a mineral developer had to conduct this research with each request. Further, the time to respond and the penalties for failure to timely provide such an abstract would be impossible to comply and would likely incentivize class action plaintiffs law firms to coordinate exhaustive title document requests.

6) **Page 3, Lines 14, 21 and 28. Section 47-16-39.1 Obligation to pay royalties**. Proposed amendment to include "the owner of an overriding royalty interest" as being entitled to 18% interest.

COMMENTS: NDPC strongly opposes the inclusion of overriding royalty interests in this statute. Even in today's higher interest rate environment, the 18% rate is three times prime rate and punitive in nature. Second, the statute was adopted in part to protect mineral owners, the theory being there exists an unequal bargaining power between a mineral owner and oil company. An overriding royalty owner should not be confused with a "mineral owner" or "royalty owner". An overriding royalty interest is fundamentally different from a mineral interest and is a carve out of the company's

working interest in a lease, and not a carve out of a mineral owner's interest. Overriding royalty owners' interests are created by contract with working interest owners and not from mineral owners, nor do they have a right to the minerals themselves. Overriding royalty owners are most often industry "pros" or professional investors. They are rarely "mineral owners." If the legislature feels compelled to include overriding royalty owners within this statute, the punitive 18% interest rate should be amended and reduced to prime rate for both mineral and overriding royalty owners.

7) **Page 4, Lines 20-21. Section 47-16-39.1(7) Obligation to pay royalties.** Proposed amendment: A claim for relief for compensation brought under this chapter must be commenced within the limitations period provided under section 28 - 01 – 15

COMMENTS: For the committee's information, the statute of limitations period referenced in Section 28-01-15 is ten years. We obviously strongly oppose. As previously noted, the 18% interest penalty is already punitive in nature. This proposed amendment would effectively amend the applicable statute of limitations period from three years to **ten** years thereby allowing a punitive 18% interest rate to accrue for ten years without the mineral owner ever bringing a claim for allegedly unpaid royalties.

8) **Page 4, Line 31 through Page 5, Line2. Section 47-16-39.2 Inspection of production and royalty payment records.** Proposed amendment: "Upon request of a royalty owner, records available in an electronic format must be electronically transmitted to the royalty owner."

COMMENTS: NDCC Section 47-16-39.2 already provides that a royalty owner is "entitled to inspect and copy the oil and gas production and royalty payment records" at the company's "customary place of business." To the extent this amendment expands that right to include an obligation to provide electronic pdf copies, NDPC companies do not necessarily object, however, if adopted, NDPC notes requiring the Company to provide electronic "pdf" records versus only making records available for inspection increases costs and increases the amount of time needed to timely respond—thirty days is not reasonable, nor are the proposed penalty provisions.

9) **The proposed attorney's fees provisions and excessive penalties in Senate Bill 2374 are unreasonable, punitive, and would incentive class action lawsuits.**

Throughout the proposed Bill are multiple proposed provisions awarding attorney's fees and severe penalties imposed for responses not made with 30 days, regardless of whether the Company was in breach of any contractual or payment obligations. As examples, *see:*

> **Page 2, Lines 29-31:** "A person who fails to comply with the requirements of this section is liable to the affected owner…in the amount of *five hundred dollars for each violation and an additional five hundred dollars for each month t*he court determines the person was not in compliance with this section [38-08-06.6]…" (emphasis added).
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> **Page 5, Lines 22-25:**"The district court shall assess a civil penalty of *two thousand dollars per day* for any period the court determines royalty payment records requested under this section [47-16-39.2]were wrongfully withheld." (emphasis added).
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> **Page 6, Lines 24-28**: "A mineral developer shall pay the mineral owner *five hundred dollars per day* for each day the court determines the mineral developer was not in compliance with this section [47-16-39.4] or wrongfully withheld information under this section. If a mineral owner brings an action to enforce this section and prevails, the court shall award reasonable attorney's fees and court costs." (emphasis added).

NDPC strongly opposes the attorney's fees provisions and, most concerning, are the $500 and $2000 per day penalties. To illustrate the extreme absurdity and punitive nature, the Bill would impose a mandatory $2000 per day penalty for each day past 30 days that a company does not respond to a mineral owner request for royalty payment records. Under this proposed amendment, a mineral owner could file ten separate requests on ten different wells. If the company responds to nine of the ten requests within 30 days, but the tenth one is not responded to for any reason, under this amendment the mineral owner (and/or their attorneys) could wait three years to file an action and be entitled to a $2.19 million dollar penalty (1095 days times $2000 per day). This is so even if the Company is in 100% compliance with its lease and royalty payment obligations to the lessor. These excessive and unlimited penalties contained in this Bill, together with the attorney's fees provisions, will incentivize class action firms to recruit plaintiffs to file multiple simultaneous requests with the goal of overwhelming operators who are unable to respond timely.

It rewards plaintiffs and plaintiffs' firms based on a "technicality" regardless of whether the underlying claim has any validity or not.

IV. CONCLUSION:

NDPC opposes Senate Bill 2374 and respectfully requests a DO NOT PASS recommendation from the Senate Natural Resources Energy Committee. However, while we oppose the Bill, we recognize that there are legitimate royalty owner concerns and communication efforts between operators and mineral owners can be improved. In that regard, the NDPC strongly supports the Royalty Owner Ombudsman Program as proposed in Senate Bill 2194. We believe this program would be of great value in enhancing better education among royalty owners and even more importantly enhance better and more efficient communications between the royalty owners and operators.