

FISCAL NOTE
Requested by Legislative Council
02/11/2015

Amendment to: HB 1374

- 1 A. **State fiscal effect:** *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	2013-2015 Biennium		2015-2017 Biennium		2017-2019 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues						
Expenditures						
Appropriations						

- 1 B. **County, city, school district and township fiscal effect:** *Identify the fiscal effect on the appropriate political subdivision.*

	2013-2015 Biennium	2015-2017 Biennium	2017-2019 Biennium
Counties			
Cities			
School Districts			
Townships			

- 2 A. **Bill and fiscal impact summary:** *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

Engrossed HB 1374 suggests a Legislative Management study of oil and gas put options, swap agreements, or other hedging strategies.

- B. **Fiscal impact sections:** *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

Engrossed HB 1374 does not have a fiscal impact.

3. **State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*

- A. **Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*
- B. **Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*
- C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation or a part of the appropriation is included in the executive budget or relates to a continuing appropriation.*

Name: Becky Keller

Agency: OMB

Telephone: 328-2148

Date Prepared: 02/12/2015

FISCAL NOTE
Requested by Legislative Council
01/19/2015

Bill/Resolution No.: HB 1374

- 1 A. **State fiscal effect:** *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	2013-2015 Biennium		2015-2017 Biennium		2017-2019 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues						
Expenditures						
Appropriations						

- 1 B. **County, city, school district and township fiscal effect:** *Identify the fiscal effect on the appropriate political subdivision.*

	2013-2015 Biennium	2015-2017 Biennium	2017-2019 Biennium
Counties			
Cities			
School Districts			
Townships			

- 2 A. **Bill and fiscal impact summary:** *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

This bill amends Section 54-44-16 to allow the State Investment Board to purchase oil swaps for OMB. The fiscal impact cannot be determined.

- B. **Fiscal impact sections:** *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

3. **State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*

- A. **Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*
- B. **Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*
- C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation or a part of the appropriation is included in the executive budget or relates to a continuing appropriation.*

Name: Becky Keller

Agency: OMB

Telephone: 328-2148

Date Prepared: 01/21/2015

2015 HOUSE INDUSTRY, BUSINESS AND LABOR

HB 1374

2015 HOUSE STANDING COMMITTEE MINUTES

Industry, Business and Labor Committee Peace Garden Room, State Capitol

HB 1374
1/26/2015
22572

- ☐ Subcommittee
☐ Conference Committee

Ellen Letang

Explanation or reason for introduction of bill/resolution:

Relating to oil and gas tax revenue put options and swaps.

Minutes:

No attachments

Chairman Keiser: Opens the hearing on HB 1374.

Andy Maragos~District 3: Introduces HB 1374. What we hope to do with the passage of this bill is add some tools to the risk management tool chest for the state of North Dakota in trying to manage the risk of the oil commodity. I apologize but the primary testifier is not available today. I have the approval with the chairman to recess the hearing until the primary sponsor can appear and give you the information.

Chairman Keiser: Committee, I ask that you hold questions and we will rehear this hearing on Tuesday afternoon.

Chairman Keiser: If there is anyone here to testify on HB 1374 today, may do so for the record. Seeing none, closes the hearing on HB 1374.

2015 HOUSE STANDING COMMITTEE MINUTES

Industry, Business and Labor Committee Peace Garden Room, State Capitol

HB 1374
2/3/2015
23152

- ☐ Subcommittee
☐ Conference Committee

Donna Wetham

Explanation or reason for introduction of bill/resolution:

Relating to oil and gas tax revenue put options and swaps.

Minutes:

Attachment #1 -3.

Chairman Keiser: reopened hearing on HB 1374.

Representative Maragos: District 3. I have amendment to the bill. (See Attachment #1). It shows what the bill will look like with the amendment and Mr. Zimmerman will testify on the amended bill, whether you pass the amendment or not. Introduced John Zimmerman.

John Zimmerman~Managing Member of Intervention Energy, LLC: Introduces and supports HB 1374. Read and explained written testimony. (1:16) (See Attachment 2 & 3).

Representative Hanson: What is the worst case scenario if we pass this?

Zimmerman: We are at max risk right now. The reason for having the bank of North Dakota language in there with these legal contracts which are the rules of the game between these two parties. North Dakota's party to represent it is the bank of North Dakota. The only risk I could really see is counter party credit risk. Let's say a counter party went solvent, to me that is the greatest risk.

Representative Hanson: Is this method more stable than what we are doing?

Zimmerman: Safer from the stand point it is a very well accepted very liquid process. It's a very standard contract and there is deep liquidity. I could envision North Dakota having multiple counter parties amongst 4- 5 entities to spread the risk.

Representative Ruby: Is this consistent with high or low swings of speculation?

Zimmerman: Speculation is a bridge to gap that is the difference between the bid offer spread, they might be people that step in at times of extreme liquidity and put their own money out there. To give you an example, one party we trade with, what they do with that

and how they trade out of that position doesn't affect us. Once the insurance is locked in we don't worry who buys that barrel of oil after we trade that with our counter party. Oil is the deepest most well traded commodity contract in the world. You would probably have the greatest level of confidence in the oil market versus any other commodity in the market.

Chairman Keiser: This is going to cost the state money to do. It's an opportunity for you and in theory what this would be bringing to the state is stability in revenue streams. That would take the peaks and valleys out of it and we would have to decide what revenue stream we want. Then negotiate from there, but that guarantees that revenue stream, but there is a cost.

Zimmerman: It depends on how you look at the cost, the actual or opportunity cost. From your side of the table having that certainty is at least some sort of clarity on where your oil prices will fall in during a biennium. The swings have cost billions of dollars now, which creates a lot of angst. From the cost standpoint and I am not a broker, we would be in a precarious place if we didn't have hedges in place. If we can manage our financial risk we should do that. From the states standpoint what is the cost? Maybe it is 50 cents a barrel as part of a bid ask for spread for that counter party to lay off that risk. I think in a context of \$30- \$50 dollar swings it is a small price to pay.

Representative Beadle: With the amendments were passed out, there is a significant change by taking the state investment board out of the game and putting it into the Bank of North Dakota. What's the rationale of taking them out?

Zimmerman: I think they were thinking about the transactional process how it would go as it stands now from OMB to the industrial commission for approval then to the Bank of North Dakota as the execution desk. It was the thought process of how it would work, the mechanics standpoint and how it would be implemented. To remain open to a process that makes sense but doesn't get too many steps. .

Chairman Keiser: Anyone in the audience who wishes to talk about the HB 1374?
Closed the hearing on HB 1374.

2015 HOUSE STANDING COMMITTEE MINUTES

Industry, Business and Labor Committee Peace Garden Room, State Capitol

HB 1374
2/9/2015
23204

- ☐ Subcommittee
☐ Conference Committee

Donna Whetham

Explanation or reason for introduction of bill/resolution:

Relating to oil and gas tax revenue put options and swaps.

Minutes:

Chairman Keiser: Reopens the work session on HB 1374. There is some real potential here with the amendment but we are in no position to do this kind of a thing. The question is should we put this into a study and request that Legislative Council consider that they look at the options and swaps relative to the oil industry?

Representative Louser: If this was a study I would strongly encourage it to be a 'shall study' because considering the unique position we are in in having a state bank and the fluctuations we have seen. It would eliminate the highs and lows and really make for budgeting in our state much more appropriate.

Chairman Keiser: It is not that I disagree with that it just goes against our protocol, if we just say shall consider than part of the committee's responsibility is to go to the leadership management and say that this is what we want. We can do 'shall' but we will get a lot of kick back on it.

Representative Laning: I would resist this bill. My own company has done this on natural gas there is potential to loose big time money. It is something we should not as a state be involved in, let the market play their games.

Chairman Keiser: What are the wishes of the study? We can take this bill up or amend it to study it. I am certainly not comfortable passing the bill.

Representative Becker: I suggest we go in that order and move an amendment do I need to make that motion.

Chairman Keiser: If I see you want the bill to be studied I will have an amendment drafted. The question is, is the trade-off for stability worth the cost.

Representative M Nelson: There is still variability in this too, even on your puts and swaps. You're in a window, you shave the peaks and valleys if you do it right.

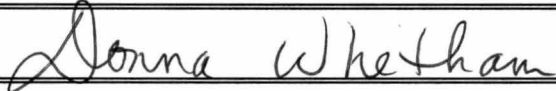
Chairman Keiser: When analysts give us their presentation, they give us the range, and where do they think it will be? It I always on the low end because it is always best to forecast revenues lower. If you budget on that, it is a good thing. I will have the amendment drafted. Closed the hearing on HB 1374.

2015 HOUSE STANDING COMMITTEE MINUTES

Industry, Business and Labor Committee Peace Garden Room, State Capitol

HB 1374
2/9/2015
23460

☐ Subcommittee
☐ Conference Committee



Explanation or reason for introduction of bill/resolution:

Relating to oil and gas tax revenue put options and swaps.

Minutes:

Attachment #1

Chairman Keiser: Reopens the work session on HB 1374. We have amendments to ask Legislative Management to consider studying the feasibility and desirability of authorizing the State Investment Board to purchase oil and gas put options and swap agreements. (See Attachment #1). I offer this for your consideration.

Representative Kasper: Is the State Investment Board currently prohibited from doing this?

Chairman Keiser: I don't think they are prohibited from doing studies. This is a complicated domain and it needs to be looked at to see if what would need to be changed and if you even want to do this.

Representative Ruby: I move to adopt the amendment 15.0902.01003 to HB 1374.

Representative Beadle: seconded.

Representative Nelson: I will probably support the bill. This is not the Investment Board managing their investments. This is the state of North Dakota hedging its tax income on oil and gas.

Chairman Keiser: That is correct.

Representative Louser: I think this warrants a study considering our unique position of having a state owned bank and such a reliance on the energy industry for our budget. I think long term if this came back as favorable recommendation out of a study.

Chairman Keiser: I don't support doing this because I simply don't know enough and it should be looked at aggressively as an option. It doesn't mean they have to accept this as a study.

Voice Vote taken on the amendment. All Ayes. Motion carried.

Representative Sukut: Moved Do Pass as Amended on HB 1374.

Representative Beadle: seconded.

A Roll Call Vote was taken. Yes: 13 No: 0 Absent: 2. Motion carried.

Representative Louser: will carry the bill.

JK
2/9/15

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1374

Page 1, line 1, after "A BILL" replace the remainder of the bill with "for an Act to provide for a legislative management study of oil and gas put options, swap agreements, or other hedging strategies.

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF NORTH DAKOTA:

SECTION 1. LEGISLATIVE MANAGEMENT STUDY - PURCHASE OF OIL AND GAS SWAPS. During the 2015-16 interim, the legislative management shall consider studying the feasibility and desirability of authorizing the state investment board to purchase oil and gas put options, enter swap agreements, or utilize any other industrial commission-approved hedging strategies with designated counterparties for the office of management and budget in order to offset reduced state general fund oil and gas tax revenues in the case of decreases in oil and gas prices. The legislative management shall report its findings and recommendations, together with any legislation required to implement the recommendations, to the sixty-fifth legislative assembly."

Renumber accordingly

Date: Feb 9, 2015

Roll Call Vote: 1

2015 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 1374

House Industry, Business & Labor Committee

☐ Subcommittee ☐ Conference Committee

Amendment LC# or Description: 15.0902.01003

Recommendation: ☒ Adopt Amendment
☐ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
Other Actions: ☐ Reconsider ☐ _____

Motion Made By Rep Ruby Seconded By Rep Beadle

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser			Representative Lefor		
Vice Chairman Sukut			Representative Louser		
Representative Beadle			Representative Ruby		
Representative Becker			Representative Amerman		
Representative Devlin			Representative Boschee		
Representative Frantsvog			Representative Hanson		
Representative Kasper			Representative M Nelson		
Representative Laning					

voice vote

Total (Yes) No _____

Absent _____

Floor Assignment _____

If the vote is on an amendment, briefly indicate intent:

voice vote - motion carries

Date: Feb 9, 2015Roll Call Vote: 2

**2015 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 1374**

House Industry, Business & Labor Committee☐ Subcommittee☐ Conference CommitteeAmendment LC# or Description: 15.0902.01003Recommendation: ☐ Adopt Amendment☒ Do Pass☐ Do Not Pass☐ Without Committee Recommendation☒ As Amended☐ Rerefer to Appropriations

Other Actions:

☐ Reconsider☐ _____Motion Made By Rep. Sukut Seconded By Rep. Beadle

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser	X		Representative Lefor	X	
Vice Chairman Sukut	X		Representative Louser	X	
Representative Beadle	X		Representative Ruby	X	
Representative Becker	X		Representative Amerman	X	
Representative Devlin	X		Representative Boschee	X	
Representative Frantsvog	Ab		Representative Hanson	X	
Representative Kasper	Ab		Representative M Nelson	Y	
Representative Laning	X				

Total (Yes) 13 No 0Absent 2Floor Assignment Rep. Louser

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1374: Industry, Business and Labor Committee (Rep. Keiser, Chairman) recommends **AMENDMENTS AS FOLLOWS** and when so amended, recommends **DO PASS** (13 YEAS, 0 NAYS, 2 ABSENT AND NOT VOTING). HB 1374 was placed on the Sixth order on the calendar.

Page 1, line 1, after "A BILL" replace the remainder of the bill with "for an Act to provide for a legislative management study of oil and gas put options, swap agreements, or other hedging strategies.

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF NORTH DAKOTA:

SECTION 1. LEGISLATIVE MANAGEMENT STUDY - PURCHASE OF OIL AND GAS SWAPS. During the 2015-16 interim, the legislative management shall consider studying the feasibility and desirability of authorizing the state investment board to purchase oil and gas put options, enter swap agreements, or utilize any other industrial commission-approved hedging strategies with designated counterparties for the office of management and budget in order to offset reduced state general fund oil and gas tax revenues in the case of decreases in oil and gas prices. The legislative management shall report its findings and recommendations, together with any legislation required to implement the recommendations, to the sixty-fifth legislative assembly."

Renumber accordingly

2015 SENATE INDUSTRY, BUSINESS AND LABOR

HB 1374

2015 SENATE STANDING COMMITTEE MINUTES

Industry, Business and Labor Committee

Roosevelt Park Room, State Capitol

Engrossed HB 1374

3/9/2015

Job Number 24483

☐ Subcommittee

☐ Conference Committee

Committee Clerk Signature



Explanation or reason for introduction of bill/resolution:

Provide for a legislative management study of oil and gas put options, swap agreements, or other hedging strategies

Minutes:

Chairman Klein: Opened the hearing.

Representative Maragos: Said that the bill has been changed to a study. We feel it is a very important issue. Unfortunately we have had two events in the price of oil that would have required some management of the risk in that down turn in the oil. The opportunity was not seized in both events and consequently the State of North Dakota was unable to protect itself in the market with investment strategies that are available. This study would study the strategies of hedging oil with the investment vehicles of put options and swaps. (:12-4:54)

Senator Campbell: What was the biggest fear for people killing your bill?

Representative Maragos: Right now my belief is that nobody wants the responsibility because they still view the market as a risky place that you could lose. (5:51-10:27)

Senator Miller: Said he had some people tell him they should do as Texas does and build some massive tank farms and store oil.

Representative Maragos: Said that two years ago he would have said that was a great idea because we had the money. Texas is more ideally suited because they are so close to the refineries. We would still have to transport the product but it is a good idea.

Chairman Klein: During the process has the State Investment Board weighed in at all? Who wants to stick their neck out and try to understand that?

Representative Maragos: Said when he adopted the bill he had to change it a lot. He had set it up he put it in the hands of the Industrial Commission at the recommendation of the Director of OMB. He said if they brought in the State Investment Board they might want to

hire somebody to focus on it because it such an important asset for North Dakota. (13:22-18:06)

Chairman Klein: I would like to hear from the State Investment Board just to see how they view these things. He closed the hearing.

2015 SENATE STANDING COMMITTEE MINUTES

Industry, Business and Labor Committee

Roosevelt Park Room, State Capitol

Engrossed HB 1374

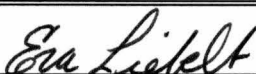
3/9/2015

Job Number 24516

☐ Subcommittee

☐ Conference Committee

Committee Clerk Signature



Explanation or reason for introduction of bill/resolution:

Provide for a legislative management study of oil and gas put options, swap agreements, or other hedging strategies

Minutes:

No Attachments

Chairman Klein: Called the meeting to order. We heard the bill this morning on puts and swaps and we only had one person speaking for the bill. I wanted to know what your perspective is and would you expound on what you believe it does?

David Hunter, Executive Director/ CIO of the Retirement and Investment Office: Said he had a little chance to look at 1374 and it is a study of oil and gas put options, swap agreements and other hedging strategies. I have thirty years of professional investment banking management and accounting experience. I have done a lot of different things with the public equity and public debt market, timber, infrastructure and real estate. I do not have a vast degree of expertise in the oil put gas, swap options market. Going back and talking with other people in the office it is my understanding that the State Investment Board and the Retirement Investment Office is not done much in this area in the past even though it is something that is being considered in the future. Legislative studies are great for understanding and getting additional knowledge and insight into how to structure things going forward. The concept in actually engaging or instructing the State Investment Board through the Retirement Investment Office and OMB to actually enter into swaps and put options for a hedging strategy is interesting, I don't know of a lot of governmental entities that would be doing that. There is a cost associated with it whenever you are entering into any financial contract, there is no free lunch. If we did enter into puts there would be a cost associated with that and you would need to have some type of budget over at OMB to say that this is designated for entering into put agreements or swap agreements. The other kind of key criteria when you enter into a swap contract it is going to be valued on a daily basis depending on how the markets are moving. The volatility we have seen in the public oil markets over the past six months it would be a significant cash flow impact that would have to be put up each time the daily markets change. Having said that studies are great for understanding what kind of risks are associated with going forward. I personally kind see it as something we would enter into at any immediate time in the future but it is always better to be more informed going forward. (:19-2:46)

Chairman Klein: We have had the put option in place for fifteen years but obviously we aren't doing that here.

David Hunter: To my knowledge we have never entered into any put options. When you step back and look at where the market was when it was at one hundred and ten dollars a barrel that would have been a great time to be selling options. It takes incredible foresight to know what is going to happen in the markets going forward and there is cost associated with it.

Chairman Klein: It is a study. I see this as something I believe the citizens or state investment board, we are concerned about risk. It will have to be a well-trained individual and there would have to be some money in another pot to make that work. It is a study and maybe if they chose it we can understand it better and figure out a way to make it work.

Senator Miller: Asked about his tank farm idea and said it isn't an outlandish idea because they do it in Texas. If we were to grasp what something like that would cost it might be a good place to utilize some of these old military installations.

Chairman Klein: We can hold on here if you have some amendments you want to craft because this would be the vehicle.

Senator Campbell: I would strongly oppose that. It is way cheaper to own paper than the commodity. You would be sitting on a hundred dollar a barrel of oil right now and dropping down. (5:20-6:06)

Senator Miller: The logic behind this is the same as what is behind the strategic reserve things that we have for oil at a national level and also what they do in Texas. We are not an individual engaged in normal business transactions we are a massive State organization that has a tremendous amount of tax revenue coming in and we also have ownership in a commodity.

Chairman Klein: Maybe we can attach an amendment. It is part of a strategic investment we would be tying up are money and the oil would be sitting somewhere.

Senator Miller: It could help the oil industry in North Dakota.

Chairman Klein: I am just suggesting adding that to part of the study because it would be difficult to get millions of dollars to build a tank farm past this session.

Senator Sinner: I was thinking about this too. I don't know that the State Investment Board is the right place to look at this. They manage the money we get. It isn't their job to maximize the money we get. (8:12-10:01)

Senator Murphy: As attractive as having tanks full of oil we just had three tanks blow up north of Killdeer, grain won't do that and paper won't do that. The point was also brought up about transportation issues and refineries and it is a little different for Texas.

Senator Campbell: Part of the study would be who to go and visit that would be expert in this. (10:52-12:29)

Chairman Klein: Closed the hearing.

Senator Murphy: Moved a do pass.

Senator Campbell: Seconded the motion.

Roll Call Vote: Yes-6 No-1 Absent-0

Senator Campbell will carry the bill.

**2015 SENATE STANDING COMMITTEE
ROLL CALL VOTES
HB 1374 Engrossed**

Senate Industry, Business and Labor Committee

☐ Subcommittee

Amendment LC# or Description: _____

Recommendation: ☐ Adopt Amendment
☒ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar
Other Actions: ☐ Reconsider ☐ _____

Motion Made By Senator Murphy Seconded By Senator Campbell

Senators	Yes	No	Senators	Yes	No
Chairman Klein	x		Senator Murphy	x	
Vice Chairman Campbell	x		Senator Sinner	x	
Senator Burckhard	x				
Senator Miller		x			
Senator Poolman	x				

Total (Yes) 6 No 1

Absent 0

Floor Assignment Senator Campbell

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1374, as engrossed: Industry, Business and Labor Committee (Sen. Klein, Chairman) recommends DO PASS (6 YEAS, 1 NAYS, 0 ABSENT AND NOT VOTING). Engrossed HB 1374 was placed on the Fourteenth order on the calendar.

2015 TESTIMONY

HB 1374

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1374

- Page 1, line 2, replace "put options and swaps" with "hedging"
- Page 1, line 6, overstrike "**put options**"
- Page 1, line 6, replace "**and swaps**" with "**hedging**"
- Page 1, line 8, overstrike "state investment board" and insert immediately thereafter "Bank of North Dakota"
- Page 1, line 8, replace "and swaps" with "and enter swap agreements or any other hedging strategies with designated counterparts approved by the industrial commission"
- Page 1, line 9, overstrike "purchase of put options"
- Page 1, line 9, remove "and swaps"
- Page 1, line 9, overstrike "must" and insert immediately thereafter "execution of any hedging strategies will"
- Page 1, line 11, after "levels" insert "included in the legislative revenue forecast at the conclusion of the most recently adjourned legislative assembly"
- Page 1, line 11, overstrike "Put options"
- Page 1, line 11, remove "and swaps"
- Page 1, line 11, overstrike "may be purchased only at such times that"
- Page 1, line 12, overstrike "the purchase assures that oil tax revenues plus the revenues from the sale of put options"
- Page 1, line 12, remove "and"
- Page 1, line 13, remove "swaps"
- Page 1, line 13, overstrike "will be in excess of the oil tax revenues estimated for that level of production by the most"
- Page 1, line 14, overstrike "recently adjourned legislative assembly."
- Page 1, line 15, overstrike "purchases of put options"
- Page 1, line 15, replace "and swaps" with "execution of hedging strategies"
- Renumber accordingly

House Bill 1374

ND Tax Revenue Insurance

Testimony by John Zimmerman
February 3, 2015

1.
HB 1374
2/3/15

As the Bill Currently Reads...

A BILL for an Act amend and reenact section 54-44-16 of the North Dakota Century Code, relating to oil and gas tax revenue put options and swaps.

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF NORTH DAKOTA:

SECTION 1. AMENDMENT. Section 54-44-16 of the North Dakota Century Code is amended and reenacted as follows:

54-44-16. Oil and gas tax revenue put options and swaps.

Upon request of the director of the office of management and budget and upon approval by the industrial commission, the state investment board may purchase oil put options and swaps for the office of management and budget. The purchase of put options and swaps must be designed to offset reduced state general fund oil and gas tax revenues due to oil and gas prices falling below selected levels. Put options and swaps may be purchased only at such times that the purchase assures that oil tax revenues plus the revenues from the sale of put options and swaps will be in excess of the oil tax revenues estimated for that level of production by the most recently adjourned legislative assembly. The office of management and budget shall report any purchases of put options and swaps to the budget section of the legislative management.

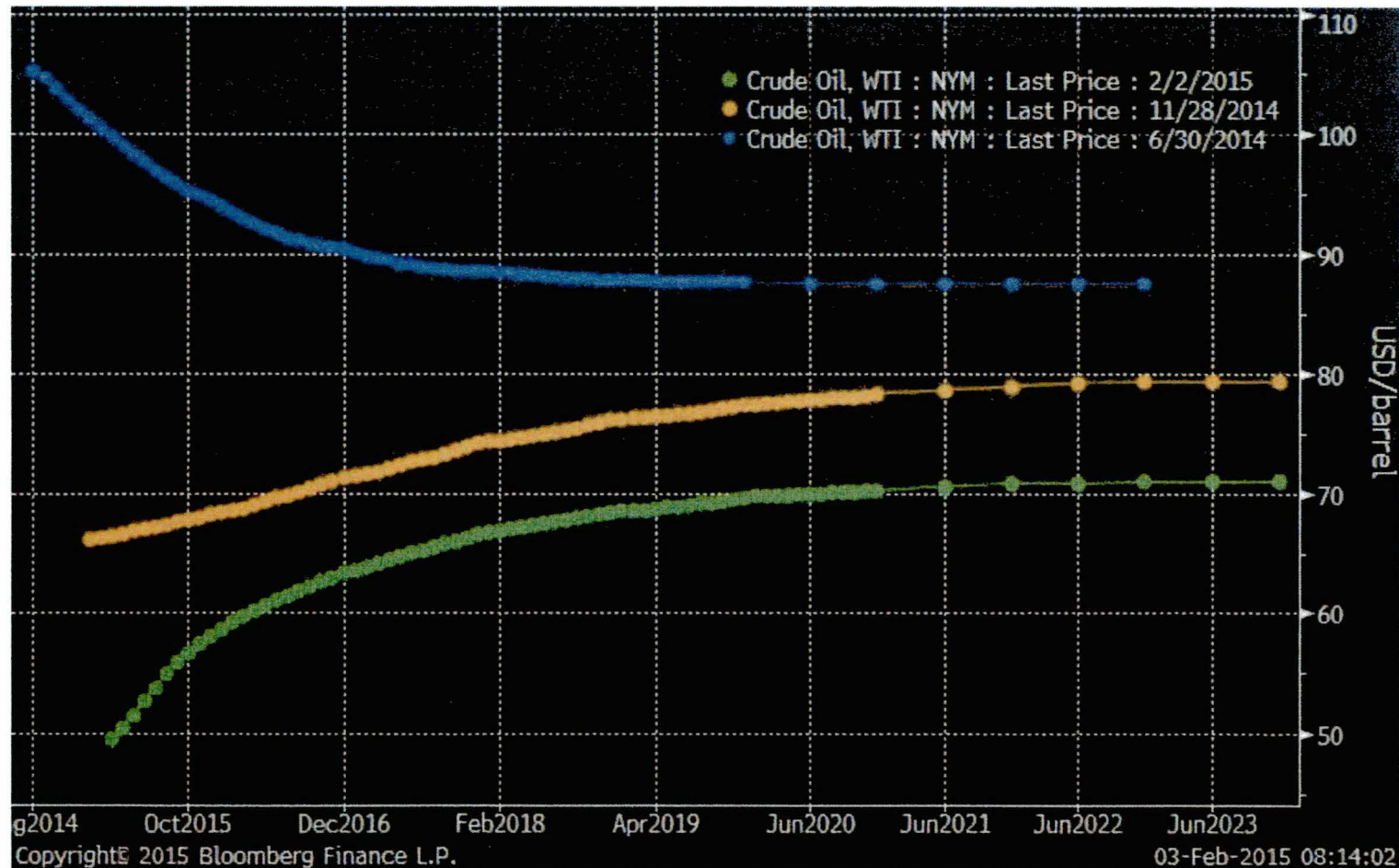
Suggested Text Amendments...

54-44-16. Oil and gas tax revenue hedging.

Text

W Upon request of the director of the office of management and budget and upon approval by the industrial commission, the Bank of North Dakota may purchase oil put options, enter into swap agreements or any other industrial commission-approved hedging strategies with designated counterparties for the office of management and budget. The execution of any hedging strategies will be designed to offset reduced state general fund oil and gas tax revenues due to oil and gas prices falling below selected levels determined by the legislative budget. The office of management and budget shall report any execution of hedging strategies to the budget section of the legislative management.

Prediction vs. Protection



A “Swap” in Simple Terms

- A “contract” between two parties that stipulates the terms of a particular “trade” between those two parties. It is governed, typically, by standard legal agreements put in place between the two parties to ensure performance on the contract. In this case, one party is “selling” and the other party is “buying”.

What a Swap Trade Would Look Like?

Based on oil prices relative to the budget, OMB request the NDIC execute a swap trade for the first year of the 2015-17 biennium



NDIC instructs BND to hedge 1,000 BOPD in swaps for July '15 – June '16



BND contacts an approved 'counter-party' and executes the trade and confirmation paperwork.



Nothing further needs to be done/traded prior to settlement (i.e. no active 'trading desk' is necessary)

Month	Sell Price	BBLS
Aug-15	\$ 56.52	31,000
Sep-15	\$ 57.42	30,000
Oct-15	\$ 58.11	31,000
Nov-15	\$ 58.84	30,000
Dec-15	\$ 59.62	31,000
Jan-16	\$ 60.20	31,000
Feb-16	\$ 60.42	29,000
Mar-16	\$ 61.16	31,000
Apr-16	\$ 61.60	30,000
May-16	\$ 62.02	31,000
Jun-16	\$ 62.55	30,000
Jul-16	\$ 62.65	31,000
Aug-16	\$ 62.64	31,000

Once the trade is complete, the state now has “sold” 397,000 barrels via swaps for the corresponding months of the budget cycle (illustrative prices using WTI prices from this morning).

Unlike buying a put option, NO “premium” payment or otherwise is made at the time of a swap trade; NO Legislative appropriation is necessary.

The state would then just let each of the months ‘settle’ based on the average WTI price for that month.

How would that look/work for the first two months as they settle?

How Does Settlement Work?

On August 1, the July average daily WTI settlement price is calculated. In this example, it turns out to be \$48.00/bbl as shown below.

Month	Sell Price	BBLS	Actual Settle	Difference	ND Recieves/Pays
Aug-15	\$ 56.52	31,000	\$ 48.00	\$8.52	\$264,120

Since the state had “sold” (via swaps) at \$56.62 & the monthly average price is \$48.00, the state collects the net settlement amount in August via a wire from the counterparty.

How Does Settlement Work?

On September 1, the August average daily WTI settlement price is calculated. In this example, it turns out to be \$65.00/bbl as shown below.

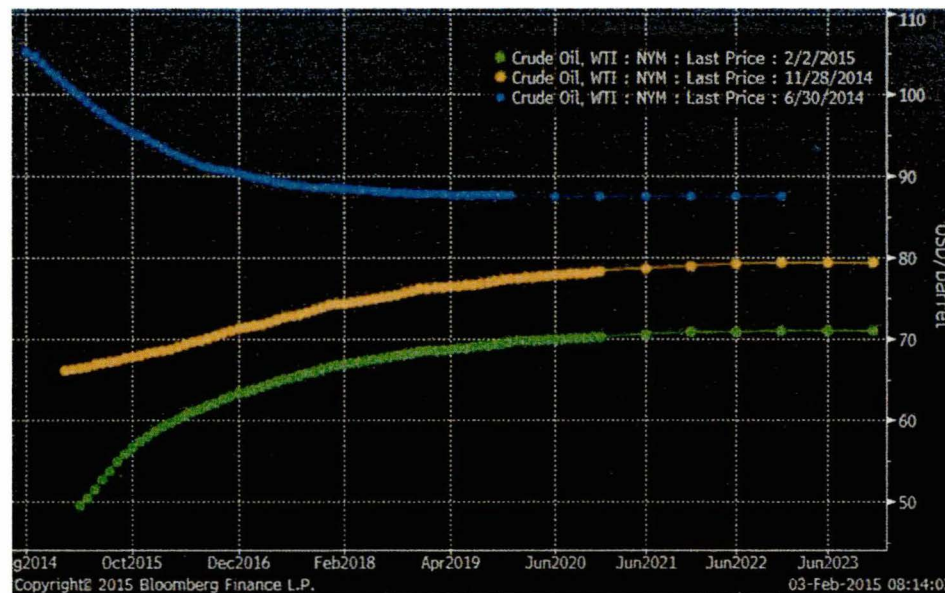
Month	Sell Price	BBLS	Actual Settle	Difference	ND Recieves/Pays
Aug-15	\$ 56.52	31,000	\$ 48.00	\$8.52	\$264,120
Sep-15	\$ 57.42	30,000	\$ 65.00	(\$7.58)	(\$227,400)

Since the state had “sold” (via swaps) at \$57.42 & the monthly average price is \$65.00, ND pays the net settlement amount to the counterparty.

The monthly settlements dovetails with when/how the state receives its tax revenues from the operators. This settlement process continues as long as there are “open” swaps between the state an its counterparty.

You Can't Trade Yesterday's Market But...

Imagine if this bill had been in place last summer when there was discussion of a special session to address infrastructure needs? The state could have "locked" in oil prices above \$90/bbl for the balance of the biennium.



Using 100,000 BOPD hedged for 12 months (Jul '14-Jun 15) the state would've had hedged 36,500,000 BO. Even using a \$30/bbl difference, this would've saved the state \$1.1 BILLION through the end of the biennium...and...*most importantly*, safely funded and underpinned that infrastructure spending.

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HB 1374

2/3/15

Mr. Chairman and Members of the Committee:

My name is John Zimmerman and I appreciate the opportunity to provide testimony today to this incredibly important, proposed bill and answer any questions you might have pertaining to it. Allow me a quick moment to provide some background as it relates to why I'm here before this Committee today.

I'm a Minot native and Managing Member of Intervention Energy, LLC, a private, Minot-based "non-op" oil and gas company. In a nutshell, we are a company that is comprised of a portfolio of interests in producing oil and gas wells and leases in the Bakken. Like many North Dakotans of past, I graduated high school and left the state for school and employment. I returned in 2005 and – as a somewhat accidental tourist – established Intervention with a handful of former colleagues from my years working in New York City.

Nothing has been more rewarding than coming back home, starting a business in my home state and being a tiny part of the amazing opportunity that is the Bakken. My background – for over 20 years now – has been in and around commodities and currency markets from being a "local" in the Minneapolis Grain Exchange spring wheat pit to trading/hedging commodities at General Mills.

I'm also here before you today also as a North Dakota taxpayer and to describe, as I see it, the unique opportunity the state of North Dakota has to shed the label of the "Biggest Speculator in the Bakken" and apply some best-practice business principles to managing the tremendous price risk the state currently endures.

As you know it and simply put, via production taxes, the state is an oil and gas "company" to the tune of approximately 100,000 barrels of oil per day at current production levels. As seen in last week's updated budget numbers, the exposure the state faces in volatile commodity prices is now measured in the BILLIONS of dollars. This bill, if properly implemented can tip the scales of predictability for planning purposes in favor of North Dakota. Additionally, this can provide a model to other states – especially oil and gas states – as to responsible fiscal and fiduciary management of taxpayer monies.

The state is uniquely positioned like no other in the United States to lead in a manner to serve all taxpayers. However, the tools needed must first come from the Legislature via a bill such as this. Next, the state has a unique feature, the Bank of North Dakota, which can act as the conduit and custodian for the Legislature and the people to execute on this bill.

"Derivatives"... "Put Options"... "Swaps"... they can seem like sinister words and, in fact, there are those who'll say why should North Dakota be gambling? I'd submit to you

we're already gambling – and we just lost \$4 billion... However, your home insurance policy is a derivative; a put option. You pay upfront to protect the value of your house. If nothing bad happens, you probably don't think twice about it and you certainly didn't think you were "gambling" when you bought the insurance.

On the other hand, if something bad happens, you're thankful for that "insurance". This bill is no different in concept. In this case, it is giving the state the ability to protect the taxpayer's "house". Fortunately, there are many tools and strategies by which the state can get similar tax revenue insurance.

I'd like to give a high-level example of how this bill might work in practice using swaps. Our company has hedged with swaps for over three years now and we currently have open hedges via swaps extending out through the first half of 2016 so this is a very familiar, "preach what your practice" sort of thing.

I now refer you to the slide deck...

Feb 9, 2015

15.0902.01003
Title.

Prepared by the Legislative Council staff for
Representative Keiser
February 6, 2015

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HB 1374
2/9/15

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1374

Page 1, line 1, after "A BILL" replace the remainder of the bill with "for an Act to provide for a legislative management study of oil and gas put options, swap agreements, or other hedging strategies.

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF NORTH DAKOTA:

SECTION 1. LEGISLATIVE MANAGEMENT STUDY - PURCHASE OF OIL AND GAS SWAPS. During the 2015-16 interim, the legislative management shall consider studying the feasibility and desirability of authorizing the state investment board to purchase oil and gas put options, enter swap agreements, or utilize any other industrial commission-approved hedging strategies with designated counter-parties for the office of management and budget in order to offset reduced state general fund oil and gas tax revenues in the case of decreases in oil and gas prices. The legislative management shall report its findings and recommendations, together with any legislation required to implement the recommendations, to the sixty-fifth legislative assembly."

Renumber accordingly