

FISCAL NOTE
Requested by Legislative Council
01/20/2015

Bill/Resolution No.: SB 2319

- 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).*

SB 2319 restricts certain oil extraction tax incentives in cases where there is a lack of compliance on the part of well owners.

- 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.*

The fiscal impact of SB 2319 cannot be estimated as it is not known how many well owners and the amount of production that may be affected by these provisions.

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: Kathryn L. Strombeck

Agency: Office of Tax Commissioner

Telephone: 328-3402

Date Prepared: 01/29/2015

2015 SENATE ENERGY AND NATURAL RESOURCES

SB 2319

2015 SENATE STANDING COMMITTEE MINUTES

Energy and Natural Resources

Fort Lincoln Room, State Capitol

SB 2319

1/30/2015

22866

☐ Subcommittee

☐ Conference Committee

Committee Clerk Signature

Kate Oliver

Explanation or reason for introduction of bill/resolution:

Relating to the integration of fractional tracts; and to provide for retroactive application.

Minutes:

4 Attachments

Chairman Schaible called the committee to order, roll was taken. Senator Laffen, Senator Hogue and Vice Chair Unruh were presenting other bills

Senator Bowman: District 39. The bill is at the request of someone who has worked in this business for 35 years. It is imperative that he has a chance for him to present what he has. It has to do with minerals and they are important to him and what he does. (1:00-2:10)

Peter Shapiro: Petroleum Geologist and Mineral Owner. See attachment #1 (2:25-14:30)

Garry Preszler: North Dakota Chapter of the National Association of Royalty Owners. See attachment #2. (16:05-19:19)

Senator Triplett: Do you have a recommendation for the rate as appropriate?

Garry Preszler: Most of the rates that I see are 1/5-1/6.

Opposition

Todd Kranda: Attorney for North Dakota Petroleum Council. See attachment 3. (21:12-24:21)

Senator Triplett: You are now saying that you object to all 3 parts of the bill.

Todd Kranda: Yes, I am not sure if there is give and take but yes.

Neutral

Bruce Hicks: Department of Mineral Resources. See attachment 4. (26:16-29:16)

Senator Armstrong: When the state leases land what is the royalty rate on that land?

Bruce Hicks: I cannot speak on behalf of the trust lands. It is my understanding that they do not go higher than 1/5.

Senator Triplett: In previous testimony. How would you evaluate this change relative to risk taking in the industry?

Bruce Hicks: As far as the industrial commission goes we did not get permission to oppose this bill. I see how it could be a burden.

Senator Triplett: Can you give us any indication of the number of complaints that maybe similar to this complaint?

Bruce Hicks: We very seldom get complaints on interests want to back in. Most of the mineral owners are in a situation where they do not want to go back in.

There was no further testimony and the hearing on SB 2319 was closed.

2015 SENATE STANDING COMMITTEE MINUTES

Energy and Natural Resources Fort Lincoln Room, State Capitol

SB 2319

1/30/2015

22934

☐ Subcommittee

☐ Conference Committee

Committee Clerk Signature

Katie Oliver

Explanation or reason for introduction of bill/resolution:

Relating to the integration of fractional tracts; and to provide for retroactive application.

Minutes:

Senator Armstrong: The royalty in working interest and working interstate to royalty issue is fatal to this bill so I will move a do not pass.

Chairman Schaible: Is there a second?

Vice Chair Unruh: Second.

Senator Armstrong: I met with Mr. Shapiro prior to the session and while I feel like I do know a lot about this topic I came out of that meeting feeling like didn't understand a lot of this. I called some other people and nobody can get their head around this, even though I see some concepts in here that make some sense. From the vast majority of royalty owners it is a solution in search of a problem. The documentation that you are talking about is extensive and as a leased royalty owner is lame. As a working interest owner you are entitled to a lot of info and as a royalty owner you get paid and that is it. The flipside is that you are not entitled to the info that the working interest owner is.

Senator Murphy: It seemed to me like Mr. Shapiro seemed to say that mineral owners are better off as interest owners. Is he wrong?

Senator Armstrong: He is. Most of these are small, fractional interests. Primarily you get to pick if you go into royalty or interest. I find it unlikely that someone will give up 80% for no risk and essentially that is what he was talking about. The only reason you would do it is if you were scared of environmental capacity.

Senator Hogue: I think that we have to fail it because if we don't the industry might pack up and leave.

Senator Triplett: I heard Mr. Kranda issue a bit of wiggle room when it comes to notification. Having said that I request we wait until next Thursday before we vote on this.

Senator Armstrong: At some point we have to start moving some of these things. The bill will have to be so different for me to support it.

There was no further discussion, roll was taken, the motion passed on a 7-0-0 count with Senator Armstrong carrying the bill to the floor.

**2015 SENATE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 2319**

Senate Energy and Natural Resources Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken Do Not Pass

Motion Made By Senator Armstrong Seconded By Vice Chair Unruh

Senators	Yes	No	Senators	Yes	No
Chairman Schaible	X		Senator Murphy	X	
Vice Chair Unruh	X		Senator Triplett	X	
Senator Armstrong	X				
Senator Hogue	X				
Senator Laffen	X				

Total (Yes) 7 No 0

Absent 0

Floor Assignment Senator Armstrong

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

REPORT OF STANDING COMMITTEE

SB 2319: Energy and Natural Resources Committee (Sen. Schaible, Chairman)
recommends **DO NOT PASS** (7 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING).
SB 2319 was placed on the Eleventh order on the calendar.

2015 TESTIMONY

SB 2319

1.1
1/30/15

SENATE BILL NO. 2319

Proposed Changes to 38-08-08

Integration of fractional tracts / Force Pooling

Introduced by Senator Bowman

Discussed by Peter Shapiro

**15.0108.02000
Sixty-fourth
Legislative Assembly
of North Dakota**

HOW FORCE POOLING WORKS

1,2

In order for oil and gas development to proceed a non-consenting mineral owner is forced by law to join the well under the following terms and phases:

Phase 1-The Penalty Period

Mineral owner is assigned a Royalty Interest of 16.66%

Expenses to drill well and maintain monthly operating costs are determined.

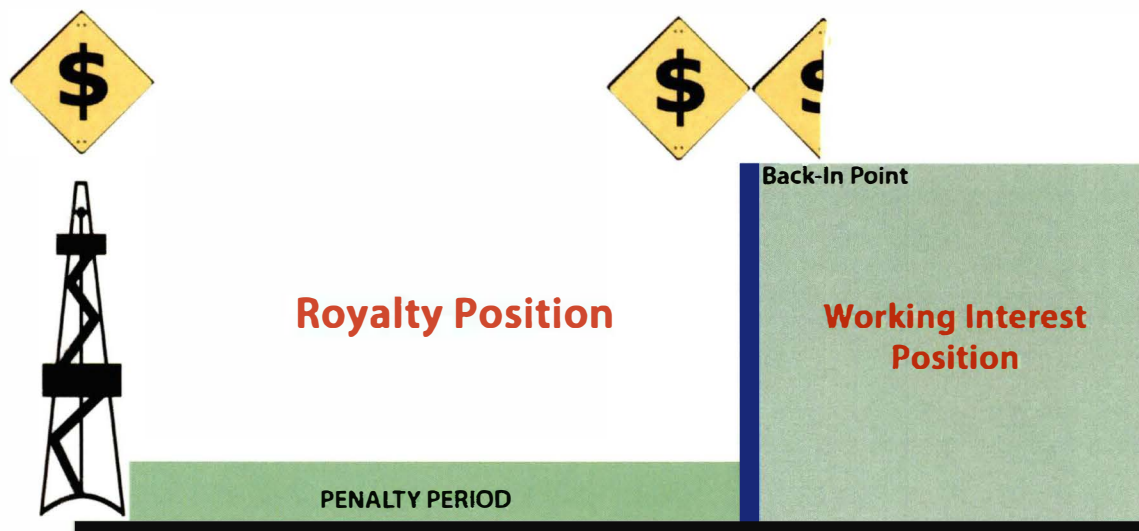
Penalty Period exists until operating company recovers 150% accrued costs.

Formula for end of Penalty Period looks like this : $\{ \text{Revenue} - (1.5X \text{ costs}) = 0 \}$

Phase 2- Back-In Point


At the end of the penalty period the royalty owner Backs-In for a new percentage of production.

Royalty Interest is replaced by a 100% pro-rata working interest.



 1.- Cost of well determined.

 2. Production begins. 16.66% Royalty Position Assigned.

 3. Well pays out 1.5 times ending penalty period. Owner's Royalty position changed to a 100% Working Interest position.

38-08-08 Integration of fractional tracts

(Force Pooling)

(Summary of Problems, Discussions, and Proposed Solutions)

PROBLEM 1:

- Inadequate information being provided to mineral owners who have been force pooled.

DISCUSSION:

- Section 38-08 of the Century Code currently has no legal reporting requirements regarding penalty-related well costs. Instead, this section relies on the good will of the operating company to supply this information to the force pooled royalty owner. Unfortunately, adherence to this "honor system" of reporting doesn't always occur.

Without complete cost information, mineral owners are unable to calculate the back-in point, and may miss a timely opportunity to increase their revenue position.

SOLUTION:

- Amend the current law to require operators to notify royalty owners of all well completion costs, and to provide all operating costs once per year when requested by mail.

See Attached Bill for amended wording (highlighted in yellow.)

PROBLEM 2:

- After the penalty period, and at the back-in point, there is only one revenue and risk option available to the force pooled royalty owner.

DISCUSSION:

- Currently, at the back-in point, the force pooled royalty owner is brought to join the well as a 100% working interest partner.

Royalty position: Safe option for a person without industry knowledge.
Guaranteed paycheck without any risk or liability.

Working Interest (WI) position: usually preferred by people with industry knowledge. It provides a greater revenue reward, but has a higher potential of risk and carries with it assumed liability.

A working interest position may not be a good idea for a mineral owner with limited Industry knowledge, as it forces the owner into an investment which assumes more risk and liability.

SOLUTION

- Allow two options for the mineral owner at the back-in point:
- Assume the current option of a pro-rated working interest position.
- Remain in a royalty position but change the royalty percentage from the current 1/6 to 1/5, the remaining 4/5 of revenue is assigned to the Operating Company.

See Attached Bill for amended wording (highlighted in blue.)

PROBLEM 3:

- Royalty differences between the State and force pooled mineral owners.

DISCUSSION

- In certain North Dakota counties, the State assigns force pooled mineral owners a royalty rate that is less than the State receives for its own mineral lands leasing program.

It would be in the best interest of North Dakota's mineral-owning constituents to be assigned the same royalty rate that the State reserves for itself.

SOLUTION:

- Assign a royalty rate to force pooled mineral owners that is equal to the royalty rate which the state receives in same county.

See Attached Bill for amended and redacted wording (highlighted in green.)

Sixty-fourth
Legislative Assembly
of North Dakota

SENATE BILL NO. 2319

1.6

Introduced by

Senator Bowman

1 A BILL for an Act to create and enact a new section to chapter 38-08 of the North Dakota
2 Century Code, relating to applications for tax reduction for a horizontal well; to amend and
3 reenact section 38-08-08 of the North Dakota Century Code, relating to the integration of
4 fractional tracts; and to provide for retroactive application.

5 **BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF NORTH DAKOTA:**

6 **SECTION 1.** A new section to chapter 38-08 of the North Dakota Century Code is created
7 and enacted as follows:

8 **Notification of force pooled royalty owners of costs.**

9 **An operator must notify each force pooled royalty owner of a property of all associated**
10 **costs of the drilling and completion of a well and provide an affidavit of fulfilling this requirement**
11 **to the oil and gas division, before the operator may certify a horizontal, horizontal reentry, or**
12 **two-year inactive well as a qualifying well for purposes of eligibility for a tax incentive under**
13 **chapter 57-51.1.**

14 **SECTION 2. AMENDMENT.** Section 38-08-08 of the North Dakota Century Code is
15 amended and reenacted as follows:

16 **38-08-08. Integration of fractional tracts.**

17 1. When two or more separately owned tracts are embraced within a spacing unit, or
18 when there are separately owned interests in all or a part of the spacing unit, then the
19 owners and royalty owners thereof may pool their interests for the development and
20 operation of the spacing unit. In the absence of voluntary pooling, the commission
21 upon the application of any interested person shall enter an order pooling all interests
22 in the spacing unit for the development and operations thereof. Each such pooling
23 order must be made after notice and hearing, and must be upon terms and conditions
24 that are just and reasonable, and that afford to the owner of each tract or interest in

the spacing unit the opportunity to recover or receive, without unnecessary expense, that owner's just and equitable share. Operations incident to the drilling of a well upon any portion of a spacing unit covered by a pooling order must be deemed, for all purposes, the conduct of such operations upon each separately owned tract in the drilling unit by the several owners thereof. That portion of the production allocated to each tract included in a spacing unit covered by a pooling order must, when produced, be deemed for all purposes to have been produced from such tract by a well drilled thereon. For the purposes of this section and section 38-08-10, any unleased mineral interest pooled by virtue of this section before August 1, 2009, is entitled to a cost-free royalty interest equal to the acreage weighted average royalty interest of the leased tracts within the spacing unit, but in no event may the royalty interest of an unleased tract be less than a one-eighth interest. An unleased mineral interest pooled after July 31, 2009 December 31, 2014, is entitled to a cost-free royalty interest equal to the acreage weighted average same royalty interest of the leased tracts within the spacing unit or, at the operator's election, of the state in the same county. The remainder of the unleased interest must be treated as a lessee or cost-bearing interest.

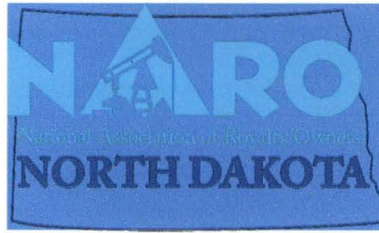
2. Each such pooling order must make provision for the drilling and operation of a well on the spacing unit, and for the payment of the reasonable actual cost thereof by the owners of interests in the spacing unit, plus a reasonable charge for supervision. In the event of any dispute as to such costs, the commission shall determine the proper costs. If one or more of the owners shall drill and operate, or pay the expenses of drilling and operating the well for the benefit of others, then, the owner or owners so drilling or operating shall, upon complying with the terms of section 38-08-10, have a lien on the share of production from the spacing unit accruing to the interest of each of the other owners for the payment of the owner's or owners' proportionate share of such expenses. All the oil and gas subject to the lien must be marketed and sold and the proceeds applied in payment of the expenses secured by such lien as provided for in section 38-08-10.
3. In addition to any costs and charges recoverable under subsections 1 and 2, if the owner of an interest in a spacing unit elects not to participate in the risk and cost of drilling a well thereon, the owner paying for the nonparticipating owner's share of the

drilling and operation of a well may recover from the nonparticipating owner a risk penalty for the risk involved in drilling the well. The recovery of a risk penalty is as follows:

- a. If the nonparticipating owner's interest in the spacing unit is derived from a lease or other contract for development, the risk penalty is two hundred percent of the nonparticipating owner's share of the reasonable actual costs of drilling and completing the well and may be recovered out of, and only out of, production from the pooled spacing unit, as provided by section 38-08-10, exclusive of any royalty or overriding royalty.
- b. If the nonparticipating owner's interest in the spacing unit is not subject to a lease or other contract for development, the risk penalty is fifty percent of the nonparticipating owner's share of the reasonable actual costs of drilling and completing the well and may be recovered out of production from the pooled spacing unit, as provided by section 38-08-10, exclusive of any royalty provided for in subsection 1.
- c. At the time the owner recovers for the nonparticipating owner's share of the drilling and operation costs of a well and any assessed penalty, the nonparticipating owner may choose to become a paying owner. If the nonparticipating owner chooses to become a paying owner, the royalty interest is converted to a working interest, proportionately reduced to the interest that the paying owner has in the spacing unit, which benefits the paying owner with all of the revenue attributable to that interest and burdens the paying owner with all of the costs associated with that interest. If the nonparticipating owner chooses not to become a paying owner, the royalty interest is increased to twenty percent of the revenues attributable to the interest that nonparticipating owner has in the spacing unit.
- d. The owner paying for the nonparticipating owner's share of the drilling and operation of a well may recover from the nonparticipating owner a risk penalty for the risk involved in drilling and completing the well only if the paying owner has made an unsuccessful, good-faith attempt to have the unleased nonparticipating owner execute a lease or to have the leased nonparticipating owner join in and

1 participate in the risk and cost of drilling the well. Before a risk penalty may be
2 imposed, the paying owner must notify the nonparticipating owner with proof of
3 service that the paying owner intends to impose a risk penalty and that the
4 nonparticipating owner may object to the risk penalty by either responding in
5 opposition to the petition for a risk penalty or if no such petition has been filed, by
6 filing an application or request for hearing with the industrial commission.

7 4. A nonparticipating owner may request in writing and the paying owner shall provide a
8 year-end accounting that includes the costs and risk penalty as defined in subsection
9 2 and 3 that have been paid by the paying owner on behalf of the nonparticipating
10 owner. The paying owner has until the end of January following the request to provide
11 the accounting.



2.1

SB 2319
SENATE ENERGY AND NATURAL RESOURCES COMMITTEE
NARO-ND, Testimony is support of SB 2319
January 30, 2015

Chairman Schaible, members of the Senate Energy and Natural Resources Committee, my name is Gary Preszler, lobbyist for the ND Chapter of the National Association of Royalty Owners.

The National Association of Royalty Owners (NARO) mission is to encourage and promote exploration and production while preserving and representing mineral owner's rights before government and the public. The ND chapter was formed in 2012 with membership already over 200.

NARO-ND is supportive of the need for greater transparency involving operator accounting for actual well costs, versus mere estimates (Page 1 beginning on line 8, and page 4 beginning on line 7).

NARO-ND is also supportive of a higher royalty rate than an average-weighted rate, or 16% (Page 2, beginning on line 12). **Note:** the bill inadvertently omits existing language on line 15 after "~~election~~" that should have included "~~a cost-free royalty interest of sixteen percent~~".

The proposed rate change to "of the state in the same county" (line 15) is problematic and needs clarification. The author's attempt, I believe, is to tie the rate to the rates offered by the Board of University and School Lands, but other agencies, such as the Game and Fish Department also offer leases. Further, the Board's rates have changed in the past, and may change in the future, which creates confusion to the parties as to the applicable rate and whether it is static. NARO-ND suggests instead that an exact rate be set in the statute.

NARO-ND supports a "do pass" recommendation by the Committee with appropriate amendments.

**Testimony in Opposition to
SENATE BILL NO. 2319
Senate Energy and Natural Resources Committee
January 30, 2015**

Attachment 3

Chairman Schaible, Senate Energy and Natural Resources Committee members, for the record my name is Todd D. Kranda. I am an attorney with the law firm of Kelsch Kelsch Ruff & Kranda in Mandan and I appear before you today as a lobbyist on behalf of the North Dakota Petroleum Council to oppose SB 2319.

As you know, the NDPC represents more than 550 companies involved in all aspects of the oil and gas industry including oil and gas production, refining, pipeline, transportation, mineral leasing, consulting, legal work, & oilfield service activities in North Dakota and has been representing the industry since 1952.

The North Dakota Petroleum Council is opposed to SB 2319. NDPC has consulted with various experts in the oil and gas industry to review and look at SB 2319. Those experts were confused to say the least regarding what SB 2319 does and how it could achieve any positive results. The experts simply did not know and were unable understand exactly what SB 2319 said or does or attempts to accomplish. However, it was determined that if the intent is to let a non-working interest back in as a working interest after the well is completed, the industry may was well pack-up and vacate. This is a business decision that they must make, it's a risky business, and it would de-risk the investment at the cost of the operator.

Accordingly, SB 2319 is completely illogical and too many questions exist to be able to implement whatever that changes are attempting to actually accomplish. Furthermore, there is no specific problem that exists that SB 2319 would adequately resolve.

In conclusion, SB 2319 should be given a **Do Not Pass** recommendation. I would be happy to try to answer any questions.



41

Senate Bill 2319
Senate Energy and Natural Resources
January 30, 2015

Testimony of Bruce E. Hicks, Assistant Director
North Dakota Industrial Commission – Department of Mineral Resources – Oil and Gas Division

Chairman Schaible and members of the Senate Energy and Natural Resources Committee, my name is Bruce Hicks. I am the Assistant Director of the Oil and Gas Division of the North Dakota Industrial Commission.

SB2319 amends North Dakota Century Code (NDCC) § 38-08-08 and imposes notification requirements on applicants seeking certain tax exemptions, allows certain parties to pay for nonparticipating owners, and changes the calculated royalty interest of unleased mineral owners.

Our department is neutral on this bill and we offer the following:

Page 2, Line 15: Incorrect Deletion

- Currently Line 15 language:
~~Unit or, at the operator's election, of the state in the same county.~~ The remainder of the
- Corrected Line 15 language:
~~Unit or, at the operator's election,~~ **a cost-free royalty interest of sixteen percent,** ~~of the state~~
in the same county. The remainder of the

Page 2, Line 15: Address Interests Pooled after 7-31-2009 and before 1-1-2015

Unleased mineral interests pooled after 7-31-2009 and before 1-1-2015 currently receive either the weighted average royalty interest of the leased tracts within the spacing unit or, at the operator's election, a cost-free royalty interest of sixteen percent. The interests pooled during that time frame need to be addressed in the statute

Page 3, Lines 16-26: Reverse Paragraphs c and d

- Paragraph d explains the "paying owner" concept and reversing paragraphs c and d will clarify the amendment

Page 3, Line 18: Clarify Paying Owner

- The term "paying owner" in Paragraph c is somewhat confusing until you realize it is talking about the nonparticipating owner actually being allowed to become an owner paying for other nonparticipating owner's costs. The language should be clarified by replacing the term "paying owner" the first time it appears in paragraph c (Page 3 Line 18) with "owner paying for nonparticipating owner's costs"

Thank you for the opportunity to comment.