2019 SENATE FINANCE AND TAXATION

SCR 4010

2019 SENATE STANDING COMMITTEE MINUTES

Finance and Taxation Committee
Lewis and Clark Room, State Capitol

SCR 4010
2/12/2019
Job # 32593

☐ Subcommittee
☐ Conference Committee

Committee Clerk: Alicia Larsgaard

Explanation or reason for introduction of bill/resolution:

A concurrent resolution directing the Legislative Management to consider studying postproduction deductions from royalty payments.

Minutes:

Attachments: 3

Chairman Cook was not present. Vice Chairman Kannianen took over the hearing on SCR 4010.

Chairman Kannianen: Called the hearing to order on SCR 4010.

Senator Brad Bekkedahl, District 1, Williston: Testified in favor of the resolution. See attachment #1 and #2. The industrial commission, after June 30th of 2019, is requiring the companies to have a more transparent statement to try and explain these deductions better. If you look on the first page (refer to attachment #2), we are looking at deduction types. This is only one oil company. On last statement in attachment #2, I am not sure but I think the majority on the directions on this one were actually the extraction and the gross production tax. You can see that there is a wide variety among the different companies operating out there in terms of post-production inductions. The study is just to try and get a handle on understanding better what they are for, why they are happening, what is the lease causes out there to allow them to happen, and whether they are prudent or if they are necessary. The study also finds where the benefits go. I will now stand for questions.

Senator Meyer: Is another goal here to potentially have uniformity amongst the deduction costs of the different companies? Do you just say you want more information? There seems to be a lot of variance between the different companies.

Senator Bekkedahl: Nobody wants do dictate best business practices to anyone in any industry including the oil industry. They all have their reasons. We just had some discussions about the geological interests as well as engineering input to the companies. There are different midstream companies involved as well. A midstream company is the one that typically gathers the gas form the well facilities and take them to some treatment facility that is called the midstream. They are a lot of entities involved in assessing the post production reductions and then the companies have to best decide how they are going to partial out the costs to the royalty owners. I am assuming that not all of these post production deduction costs for these transportations are being picked up by the royalty owner. My assumption is that the companies have some cost in that.

Brady Pelton, ND Petroleum Council: Testified in support of the resolution. See attachment #3. Last session the legislature commissioned a study on the evaluation of oil and gas which you should have in front of you now. That study was presented before the Energy and Development Transmission Committee as a complete product on August 14, 2018. That study concluded that no statutory changes are necessary at this time. We feel that more information as Senator Bekkedahl has indicated, may be at hang and should be analyzed and discussed. Senator Meyer mentioned the question of uniformity in terms of deducts that are a part of every company's royalty statement. Last October of 2017, administrative rule changes were put into effect through the industrial commission. If you look at page 10 of my attachment, you will see a comparison of the current royalty statement requirements and a comparison of what the administrative rules process has brought into the equation. On July 1 of this year, several changes will occur. One of them is related to the amount and purpose of deducts in royalty statements. You will see there are 4 categories listed there. Those 4 categories are now what our companies are striving to put into their royalty statements to accommodate those administrative rule changes and those 4 categories for deducts. We have worked very hard as an industry to accommodate those changes and bring more clarity to royalty owners in exactly what deducts are being taken out. In order to do that, we have assembled a royalty statement workgroup. They have collaborated on finding ways that may change their royalty statements in a way that provides useful information to the royalty owner while still meeting those new administrative rule requirements. This group has solicited feedback from the Department of Mineral Resources on how to provide that useful information to royalty owners in a useful way. This feedback has been incorporated into our discussions. The software systems are fairly complex. We are trying our best to make it as clear as possible. I think those 4 categories of deducts will be helpful in that process as well. This is a substantial change to royalty statements. It is very expensive. WE are lucky to have departments that are willing to work with us. This work will continue. Our companies are still in the process of changing over their royalty statements to be compliant with that July 1, 2019 rule deadline. We are in support of this resolution as it might bring more clarity to the royalty deducts issue. I will stand for questions.

Chairman Kannianen: Do you know if the deductions are shared between the company and the royalty owner based on the percentage of the royalty? Is it mainly on the back of the royalty owner? How does that work?

Brady Pelton: My understanding is that it is a shared cost.

Chairman Kannienen: So as an example, this first one from XTO where is shows the gross value was $550 with a $150 deduction, that is a pretty large percentage. Can we assume that the company itself had such a large percentage of a reduction on their own side too? Is that mainly the royalty owner that would have such a large deduction?

Brady Pelton: Without having this royalty statement in front of me, I wouldn't want to make a guess on that.

Chairman Kannianen: That would be something I am interested in knowing. It seems like such a high percentage.

Senator Patten: It might be helpful in that case to give an example of an ownership in a well as it relates to the operating company and the non-operating company royalty owners. Just because a mineral owner has an interest in it, there is also other interests in that if you give a little background on that. That would provide a basis for how these costs are split up.

Senator Dotzenrod: I would like to ask a question about page 10. Is this statement on this page a mandate? Is it something that is supposed to take the place of something that we do now? Is it in addition to whatever the royalty owner currently gets? Is this a suggestion? Is this something they have to do?

Brady Pelton: Page 10 indicates the administrative rule pertaining to royalty owner information statements. This has the full effect of law and is what is required. It has gone through the public hearing process. The determination has been made and reviewed by the legislative administrative rules committee. It is in the ND administrative code right now. This is the finer points of what is required.

Senator Dotzenrod: Would the royalty owner expect they would get that normal statement they have received in the past but there will be something additional? Do they know there is new data we are requiring?

Brady Pelton: That is correct. The information that is on page 10 is all the information that will be required to be in a royalty statement moving forward after July 1, 2019. The royalty statement will change to accommodate those rule changes that have been made in that particular section of the administrative code.

Chairman Kannianen: Any further testimony in support? Any testimony opposed? Any neutral testimony?

Senator Dotzenrod: Moved a Do Pass on SCR 4010.

Senator Meyer: Seconded.

Chairman Kannianen: Any Discussion?

A Roll Call Vote Was Taken. 4 yeas, 0 nays, 2 absent.

Motion Carried.

Senator Dotzenrod will carry the bill.

Date: 2-12-19
Roll Call Vote #: 1

2019 SENATE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 4010

Senate Finance and Taxation 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 Dotzenrod Seconded By Meyer

Senators	Yes	No	Senators	Yes	No
Chairman Cook			Senator Dotzenrod	✓	
Vice Chairman Kannianen	✓				
Senator Meyer	✓				
Senator Patten	✓				
Senator Unruh					

Total (Yes) 4 No 0

Absent 2

Floor Assignment Dotzenrod

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

REPORT OF STANDING COMMITTEE

SCR 4010: Finance and Taxation Committee (Sen. Cook, Chairman) recommends **DO PASS** (4 YEAS, 0 NAYS, 2 ABSENT AND NOT VOTING). SCR 4010 was placed on the Eleventh order on the calendar.

2019 HOUSE FINANCE AND TAXATION

SCR 4010

2019 HOUSE STANDING COMMITTEE MINUTES

Finance and Taxation Committee
Fort Totten Room, State Capitol

SCR 4010
3/6/2019
33316

☐ Subcommittee
☐ Conference Committee

Committee Clerk: Mary Brucker

Explanation or reason for introduction of bill/resolution:

A concurrent resolution directing the Legislative Management to consider studying postproduction deductions from royalty payments.

Minutes: Attachment 1-2

Chairman Headland: Opened hearing on SCR 4010.

Senator Bekkedahl: Introduced bill. Distributed written testimony, see attachment 1. Ended testimony at 4:24.

Representative B. Koppelman: Would we have to go back and see if we're taxing too high? We're already taxing at a higher rate than the other states.

Senator Bekkedahl: Post production deductions are relatively new to North Dakota. Leases were changed in the last decade to allow this to happen. The people out west said these post production deductions have only been happening for the last two to four years. Royalty interest owners are not afraid to pay a part of the cost of this if that's what has to happen to reduce the flaring but they are not enjoying the loss of oil revenue to cover these costs that they've never seen in the past. How much of these costs are an industry business expense and shouldn't be passed back down to the royalty interest owner? I don't disagree with your premise but I think it is more complex than that.

Chairman Headland: Is there further testimony in support?

Brady Pelton, represents the North Dakota Petroleum Council: Distributed written testimony, see attachment 2. Ended testimony at 11:56.

Chairman Headland: Further testimony in support? Is there opposition? Seeing none we will close the hearing. What are the committee's wishes?

Representative Steiner: MADE A MOTION FOR A DO PASS

Representative Trottier: SECONDED

Chairman Headland: Discussion?

Representative B. Koppelman: This would be studying whether or not the state should meddle in private contract law or not. A couple sessions ago we heard a lot of complaining about the flaring so the industrial commission did something about the flaring. Now that the flaring is gone they are complaining about the cost to get rid of the flaring. That's what we were hearing about the gas deducts. If it's in their contract they should litigate that if they can't come to terms. I don't know if that's the best policy. I'm going to resist the motion.

Representative Steiner: I don't know what you're talking about because flaring is not fixed. The state has an interest in this as well. This has only happened in the last three or four years. I know we can't interfere with the personal contracts but because industry supported it and we have an interest with our own royalty statements, I think we should at least give it to Legislative Management to study. I think that's reasonable.

Representative Hatlestad: There was a court case three or four years ago and the interpretation was by the oil companies that they could do all of this. They had never charged it before and now here was a chance to enrich their profit bottom line because of the court case. If you get a royalty statement, it's amazing all the things they deduct. You could almost end up with a negative. I would favor this.

Representative B. Koppelman: The state took efforts to reduce flaring because many people that lived around the wells didn't like that. I believe it's written in their leases that they could do it and that's why the court would have sided that way. If we study whether or not those deductions should be allowed to happen then there are only two outcomes; if we honor the contract or we don't then we come up with a law that undoes the contract. The first example we wouldn't need the study to do but the second example just sounds like a bad outcome. I don't know why we would want the study. I'm going to resist this.

Chairman Headland: Is there anything else?

ROLL CALL VOTE: 7 YES 7 NO 0 ABSENT
MOTION FAILED

Representative B. Koppelman: MADE A MOTION FOR A DO NOT PASS

Representative Ertelt: SECONDED

Chairman Headland: Discussion?

ROLL CALL VOTE: 7 YES 7 NO 0 ABSENT
MOTION FAILED

Chairman Headland: I'll change my vote and we'll move this forward.

Representative Steiner: MADE A MOTION FOR A DO PASS

Representative Trottier: SECONDED

ROLL CALL VOTE: 9 YES 5 NO 0 ABSENT
MOTION CARRIED

Representative Steiner will carry this bill.

Date: 3-6-19
Roll Call Vote #: 1

2019 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. SCR 4010

House Finance and Taxation 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 Rep. Steiner Seconded By Rep. Trottier

Representatives	Yes	No	Representatives	Yes	No
Chairman Headland		X	Representative Eidson	X	
Vice Chairman Grueneich	X		Representative Mitskog	X	
Representative Blum	X				
Representative Dockter		X			
Representative Ertelt		X			
Representative Fisher		X			
Representative Hatlestad	X				
Representative Kading		X			
Representative Koppelman		X			
Representative Steiner	X				
Representative Toman		X			
Representative Trottier	X				

Total (Yes) 7 No 7

Absent 0

Floor Assignment ______

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

Motion failed

Date: 3-6-19
Roll Call Vote #: 2

2019 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. SCR 4010

House Finance and Taxation 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 Rep. Koppelman Seconded By Rep. Ertelt

Representatives	Yes	No	Representatives	Yes	No
Chairman Headland	X		Representative Eidson		X
Vice Chairman Grueneich		X	Representative Mitskog		X
Representative Blum		X			
Representative Dockter	X				
Representative Ertelt	X				
Representative Fisher	X				
Representative Hatlestad		X			
Representative Kading	X				
Representative Koppelman	X				
Representative Steiner		X			
Representative Toman	X				
Representative Trottier		X			

Total (Yes) 7 No 7

Absent 0

Floor Assignment ______

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

Motion failed.

Date: 3-6-19
Roll Call Vote #: 3

2019 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. SCR 4010

House Finance and Taxation 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 Rep. Steiner Seconded By Rep. Trottier

Representatives	Yes	No	Representatives	Yes	No
Chairman Headland	X		Representative Eidson	X	
Vice Chairman Grueneich	X		Representative Mitskog	X	
Representative Blum	X				
Representative Dockter		X			
Representative Ertelt		X			
Representative Fisher		X			
Representative Hatlestad	X				
Representative Kading	X				
Representative Koppelman		X			
Representative Steiner	X				
Representative Toman		X			
Representative Trottier	X				

Total (Yes) 9 No 5

Absent 0

Floor Assignment Rep. Steiner

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

REPORT OF STANDING COMMITTEE

SCR 4010: Finance and Taxation Committee (Rep. Headland, Chairman) recommends **DO PASS** (9 YEAS, 5 NAYS, 0 ABSENT AND NOT VOTING). SCR 4010 was placed on the Fourteenth order on the calendar.

2019 TESTIMONY

SCR 4010

Senate Finance and Tax Committee. February 12, 2019
Honorable Senator Dwight Cook, Chairman
Senate Concurrent Resolution 4010
Testimony by Senator Brad Bekkedahl

Senator Cook and Committee members,

SCR 4010 is a study resolution to look at post-production deductions. As the name indicates, there is a practice among oil and gas operators in North Dakota to deduct costs for oil/gas gathering, transportation, compression, treating, processing, and marketing. The issue of the amount of deductions occurring was first brought to our attention in the 2017 legislative session but was not addressed formally in any way. In the 2017-19 Interim, the Energy Development and Transmission Committee informally looked at the issue after concerns expressed by many royalty interest owners in the State. While the industry maintains they are following all law and statute and have authority in the individual lease agreements signed by the royalty interest owners to assess post-production deductions, there has continued to be complaints from royalty owners to the state and legislators. There is currently an association of royalty owners in North Dakota forming to be more organized in the effort to address this issue. This history and discussions among Legislators led to the introduction of this study resolution for consideration by Legislative Management in the 2019-21 Interim. It should be noted also that the State, which has very large royalty interests has also been incurring post-production deductions on some of its holdings and is responding to litigation in its attempts to recover these deductions, which are prohibited by language in most of the leases the State holds now.

Mr. Chairman, this issue is not solely in North Dakota. Other oil and gas producing states have taken an interest in looking at these deduction practices as well, with some states introducing and passing legislation limiting or prohibiting the practice. The ones that have passed bills are in litigation at this time, so the study may give some insight as to what has happened elsewhere, and what, if anything should be addressed here in North Dakota. As you can see, the study is designed to get representation from all the parties interested, including the oil and gas industry, royalty owners, the department of mineral resources, the department of trust lands, the attorney general's office, and other state agencies. And the industry has been extremely cooperative in working with individual legislators and committees, particularly as it relates to the new royalty statements required by the Industrial Commission to provide further clarification and transparency to the owners. It is hoped this study will be comprehensive enough to bring resolution either by better understanding the practice of post-production deductions or looking at best practices on behalf of royalty interest owners.

I am including a few copies of different royalty statements for the committee to see how the deductions are noted in some company's correspondence to royalty owners. I appreciate the committee's consideration of SCR 4010 and will stand for any questions.

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#2 pg. 1

PRODUCTION TYPE / DESCRIPTION / MEASUREMENT

CO2	CARBON DIOXIDE	MCF
CON	CONDENSATE	BARRELS
DRP	DRIP CONDENSATE	BARRELS
FLA	UPSTREAM FUEL	MCF
FLB	DOWNSTREAM FUEL	MCF
FLR	FLARE	MCF
GAS	NATURAL GAS	MCF
GML	GAS USED IN MANUFACTURE OF LIQUIDS	MCF
HEL	HELIUM	MCF
L&U	LOSS AND UNACCOUNTED FOR	MCF
LNG	LIQUEFIED NATURAL GAS	MCF
NGL	NATURAL GAS LIQUIDS	GALLONS
OIL	CRUDE OIL	BARRELS
RES	RESIDUE	MCF
SUL	SULPHUR	MCF

DEDUCTION TYPES

COM	COMPRESSION
DEH	DEHYDRATION
FLA	UPSTREAM FUEL
FLB	DOWNSTREAM FUEL
GAT	GATHERING
L&U	LOSS AND UNACCOUNTED FOR
MKT	MARKETING
OTH	OTHER
PRO	PROCESSING
RTU	ROYALTY TRUE UP
TRN	TRANSPORTATION
TRT	TREATING/CONDITIONING

INTEREST TYPES

OC	EXCESS ROYALTY
OR	OVERRIDING ROYALTY INTEREST
PP	PRODUCTION PAYMENT
RI	ROYALTY INTEREST
WI	WORKING INTEREST

TAX TYPES

ADV	AD VALOREM TAX
CA	CALIFORNIA STATE TAX WITHHOLDING
CO	COLORADO STATE MINERAL TAX WITHHOLDING
CON	CONSERVATION TAX
ENV	ENVIRONMENTAL TAX (CLEAN UP FEE)
FED	FEDERAL BACKUP TAX WITHHOLDING
IND	INDIAN TAX
MT	MONTANA STATE TAX WITHHOLDING
ND	NORTH DAKOTA STATE TAX WITHHOLDING
NM	NEW MEXICO STATE TAX WITHHOLDING
NRA	FEDERAL NON-RESIDENT ALIEN
OK	OKLAHOMA STATE TAX WITHHOLDING
PA	PENNSYLVANIA STATE TAX WITHHOLDING
SCH	SCHOOL TAX (NM)
SEV	SEVERANCE TAX
UT	UTAH STATE MINERAL TAX WITHHOLDING

OTHER PAYMENT TYPES

INT	INTEREST PAID
MIS	MISCELLANEOUS
SML	SETTLEMENT

CHECK STUB MESSAGES

TPS://WWW.XTOENERGY.COM/
LICK ON INTEREST OWNER RELATIONS LINK AT THE TOP
- VIEW AND PRINT CHECK AND PAYMENT HISTORY
- ACCESS DIRECT DEPOSIT, CHANGE OF ADDRESS, AND 1099 FORMS
- FIND ANSWERS TO FREQUENTLY ASKED QUESTIONS
FOR FURTHER INFORMATION PLEASE CONTACT US AT REVENUE_INQUIRY@XTOENERGY.COM

XTO Energy Inc.
110 West 7th Street
Fort Worth, TX 76102-7108

XTO ENERGY INC.
WHEN INQUIRING, REFER TO YOUR BP NO., PROPERTY DOI NO., CHECK DATE
1-866-886-2613 EMAIL: revenue_inquiry@xtoenergy.com
XTO ENERGY, INC. ACTING ON BEHALF OF ITSELF AND/OR ITS AFFILIATES

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0201525 03 RE 1.010 **AUTO T2 1 2452 58801 -P01526

[redacted]

*** * * STATEMENT DETAILS ENCLOSED * * ***

Oil/Gas Payment Statement
SHOULD BE RETAINED FOR TAX PURPOSES

CHECK DATE	CHECK #	YOUR BP NO.	GROSS VALUE	TAXES	DEDUCTIONS	NET PAYMENT
01/25/2019	1000023145	30137027	$550.04	$39.96-	$150.22-	$359.86

XTO ENERGY INC. BELIEVES THAT THE PAYMENTS COVERED BY THIS CHECK HAVE BEEN CALCULATED APPROPRIATELY. HOWEVER, IF A MISTAKE IS IDENTIFIED THEN XTO ENERGY INC. MAY CORRECT THE PAYMENT. XTO ENERGY INC. DOES NOT WAIVE AND EXPLICITLY RESERVES ALL LEGAL RIGHTS, DEFENSES, AND CLAIMS PERTAINING TO ROYALTY UNDER THE APPLICABLE LEASE(S).

DETACH AND RETAIN THIS STUB FOR YOUR RECORDS

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CONTINENTAL RESOURCES, INC
OKLAHOMA CITY, OK 73126 (405) 774-5257

Owner No.	Check No.	Check Date
21054203	E100932642	01/28/2019

Prod Code	Interest Types		Deduct Codes			Other Adjustment Codes
O - Oil	WI - Working Interest	MI - Unleased Mineral Int	CO - Compression	PR - Processing	TR - Transportation	IN - Interest Paid
G - Gas	WR - Working Other	OW - Override Working Int	GA - Gathering	MK - Marketing Fee	OT - Other	MS - Miscellaneous
	RI - Royalty Interest	OU - Override Unsigned	LF - Line Fill Fee	TG - Treating		SW - State (Income Tax) Withholding
	RU - Royalty Unsigned	OR - Overriding Royalty				

Property Number/DOI Number/Name | County, State

Prod Date	Prod Code	BTU Factor	Int Type	Record Decimal	Disb Decimal	Price	Gross Volume	Gross Gr Value	Gross Taxes	Gross Deducts	Gross Net Amt	Owner Volume	Owner Gr Value	Owner Taxes	Owner Deducts	Code	Owner Net Amt
12/18	O		RI01	0.00097656	0.00097656	34.24	8,009.57	274,226.85	-27,422.68	-551.00 -842.25 -671.20 -282.74 -388.46	246,132.97	7.82	267.80	-26.78	-0.82 -0.38	GA LF	240.64
12/18	O		RI02	0.00097656	0.00097656	34.24	8,009.57	274,226.85	-27,422.68	-671.20 -282.74 -388.46	246,132.97	7.82	267.80	-26.78	-0.38 -0.38 -0.38	GA LF GA LF	240.64
09/18	G	1.539	RI01	0.00097656	0.00097656	3.27	14,891.00	48,650.37	-1,101.45		47,548.92	14.54	47.51	-1.08			46.43
09/18	G	1.539	RI02	0.00097656	0.00097656	3.27	14,891.00	48,650.37	-1,101.45		47,548.92	14.54	47.51	-1.08			46.43
10/18	G	1.486	RI01	0.00097656	0.00097656	3.10	29,144.00	90,440.83	-2,137.00		88,303.83	28.46	88.32	-2.09			86.23
10/18	G	1.486	RI02	0.00097656	0.00097656	3.10	29,144.00	90,440.83	-2,137.00		88,303.83	28.46	88.32	-2.09			86.23
11/18	G	1.536	RI01	0.00097656	0.00097656	2.33	27,862.00	65,004.55	-1,964.28		63,040.27	27.21	63.48	-1.92			61.56
11/18	G	1.536	RI02	0.00097656	0.00097656	2.33	27,862.00	65,004.55	-1,964.28		63,040.27	27.21	63.48	-1.92			61.56
Property Totals:													7,035.12	-673.82	-8.02		6,353.28

OWNER TOTALS

	Gr Value	Taxes	Deducts	Net Amt
Total Before Other Adjustments:	13,927.52	-1,321.69	-15.96	12,589.87
Interest Paid:				0.00
Miscellaneous:				0.00
State (Income Tax) Withholding:				0.00
NRA/Backup (Income Tax) Withholding:				0.00
Owner Check Amount:				12,589.87

[redacted]

[redacted] # 17492001

HESS BAKKEN INVESTMENTS II, LLC
P.O. BOX 2040
HOUSTON, TX 77252
Toll Free 1-844-275-4377
http://ownerrelations.hess.com

CHECK NUMBER	E009142599
CHECK AMOUNT	1,208.97
CHECK DATE	1/25/19

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PROP/ST/CTY			GROSS INTEREST						OWNER INTEREST					
PROD MNTH	PROD CODE	TX	GROSS VOLUME	$ PRICE	$ GROSS VALUE	$ TAXES	$OTHER DEDUCTION	$ NET VALUE	DISB. DECIMAL	INT TYPE	$ GROSS VALUE	$ TAXES	$OTHER DEDUCTIONS	$ NET VALUE
									OWNER TOTAL		1,579.08	131.84	238.27	1,208.97

PRODUCT CODES: 1XX - OIL (BBLS) 2XX - GAS (MCF) 3XX - CONDENSATE (BBLS) 4XX - PLANT PRODUCTS (GALS) 9XX - JOINT VENTURE EXPENSES
TAX CODE (TX): 12 - STATE INCOME TAX WITHHOLDING

015040202N0000 - P9IODN00101504

8009080

OASIS PETROLEUM

OASIS PETROLEUM - ROYALTY
1001 FANNIN, SUITE 1500
HOUSTON, TX 77002
855-209-8370

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Payee No.	Payee Name	Check Date	Check Number	Check Total
[redacted]		12/28/2018	0000654151	$*********225.18

WELL# / SALE DATE	PC	TYP INT	UNIT VALUE	QUANTITY	VALUE	GROSS DEDUCTIONS	NET	OWNER INTEREST	PAID INT	OWNER VALUE	OWNER DEDUCTIONS	NET SHARE
P17182.1			OSPREY 5401 44-23H			NDWilliams		Section: 14 Township: 154-N Range: 101-W				
10/18	GAS	WU	6.38	21391.53	136417.76	108776.32 CMG	25377.46	0.00037086	0.00037086	50.59	40.93 CMG	8.81
						2263.98 ND_SEV					0.85 ND_SEV	
11/18	OIL	WU	49.32	15009.79	740354.95	32486.64 ND_MET	584759.60	0.00037086	0.00037086	274.57	12.05 ND_MET	216.37
						32486.64 ND_SEV					12.05 ND_SEV	
						90622.07 TRN					34.10 TRN	

	OWNER GROSS	OTHER ADJUSTMENTS	OWNER NET DEDUCTIONS	OWNER NET TOTALS
CURRENT CHECK	325.16	0.00	99.98	225.18

---------PRODUCTS/DEDUCTIONS---------

CMG - COMPRESSION, GATHERING, & TREAT/ ND_SEV - SEVERANCE TAX/ ND_MET - ND MINERAL EXTRACTION TAX/ TRN - TRANSPORTATION/

Note to Royalty Interest Owners: The amount(s) in the "DEDUCTIONS" column may be greater than the amount in the "VALUE" column; however, the amount in the "NET" column will not be negative, as negative amounts are not being assessed against your royalty interest.

TOTAL CHECK AMOUNT 225.18

For **Oasis Owner Relations**, call toll-free **1-855-209-8370**. Also, Oasis has teamed up with FIS Integrated Payables to offer you new services! You can **sign up** for direct deposit, emailed payment notifications, and online check stubs (up to one history year available online) at **https://www.fisintegratedpayables.com/payments/login.aspx** using your personal subscription code **88FFADB9**. Once enrolled, mailed payment advice will stop. For **Direct Deposit Setup** assistance, call FIS Integrated Payables toll-free at 1-877-330-4950.

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APPENDIX M

2018 Oil and Gas Valuation Study

ND Tax
NORTH DAKOTA

Ryan Rauschenberger
Tax Commissioner

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Oil & Gas Valuation Study

Chapter 38 of the 2017 Laws of North Dakota (Session Laws):

SECTION 28. AMENDMENT. Section 21 of Senate Bill No. 2013 as approved by the sixty-fifth legislative assembly, is amended and reenacted as follows:

SECTION 21. STUDY OF OIL AND GAS VALUATION – REPORT TO ENERGY DEVELOPMENT AND TRANSMISSION COMMITTEE.

1. During the 2017 18 interim, the tax department, in consultation with the board of university and school lands, the industrial commission, and other state agencies as necessary, shall consider studying the valuation of oil and gas as used to determine mineral royalty payments and tax liability. The study must include consideration of the following:
    a. The methods used to calculate the value of oil and gas, including changes in custody, the basis for the value, any deductions or incentives applied to the value, and the point at which the value is determined.
    b. The impact of state and federal regulations, including gas capture requirements.
    c. The reporting of any deductions or incentives applied to the value as included on mineral royalty statements and tax reporting documents.
2. The tax department shall report to the energy development and transmission committee by September 30, 2018, regarding the results and recommendations of the study.

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Gross Production Tax on Natural Gas

Tax Base, Tax Rate, Exemptions and Collections

- The gross production tax on gas is an annually adjusted flat rate per thousand cubic feet (MCF) on all gas produced in the state that is not exempt
- The rate was established in HB 1098, 1991 Session, as $.04 per MCF – which was deemed fairly close to "revenue – neutral" when compared to the existing value based, 5% gross production tax rate
- The change from a value-based tax to a flat-rate tax on natural gas was a result of a collaborative effort between the Tax Department and the North Dakota Petroleum Council, to address on-going differences in gas valuation that were taking up valuable resources and resulting in costly litigation with very little "return" for either the industry or the state
- Procedures for annual rate adjustments were established in the 1991 legislation utilizing changes to the average producer price index for gas fuels, a method which is still used today
- Recent gross production tax rates for natural gas are as follows:
  - FY 2018 $.0550 (per MCF of gas produced)
  - FY 2017 $.0601
  - FY 2016 $.1106
  - FY 2015 $.0982
- Exemptions from the gross production tax on natural gas include:
  - Gas used on the lease for production purposes
  - Royalty interest from a federal, state, or municipal holding
  - An interest held by an organized Indian tribe
  - Gas that would otherwise be flared that is used in a generation unit to produce electricity for the well site
- Recent gross production tax collections on natural gas are as follows:
  - FY 2017 $33,275,164
  - FY 2016 $48,864,428
  - FY 2015 $32,959,075
  - FY 2014 $19,090,268

Gross Production Tax on Oil

Tax Base, Tax Rate, Exemptions and Collections

- The gross production tax on oil is levied at the rate of 5% of the gross value at the well
- The 5% rate was established in 1957, when it was increased from 4.25%
- The gross production tax is a real property tax, as codified by actions of the 1989 legislature
- In determining the gross value at the well for purposes of calculating the tax, costs associated with transporting the oil from the point of production to the point of sale are deductible
- Exemptions from the gross production tax on oil include:
  - Royalty interest in oil produced from a federal, state, or municipal holding
  - An interest held by an organized Indian tribe
- Recent gross production tax collections on oil are as follows:
  - FY 2017 $ 733,155,672
  - FY 2016 $ 701,610,076
  - FY 2015 $1,253,693,346
  - FY 2014 $1,473,892,184

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Oil & Gas Valuation Study Meeting Minutes
September 12, 2017

Persons in Attendance:
Senator Rich Wardner, Lt. Governor Brent Sanford, Tax Commissioner Ryan Rauschenberger, Joe Morrissette, Dee Wald, Ken Herman, Kathy Strombeck, Office of State Commissioner; Ron Ness, Brady Pelton, North Dakota Petroleum Council; Lynn Helms, Department of Mineral Resources; Land Commissioner Lance Gaebe; Justin Kringstad, ND Pipeline Authority; Troy Seibel, Attorney General's Office; Taylor Lee, Bob Skarphol, Anne Skarphol, Lloyd Ness, Mary Ness, Matt Kelly.

Meeting Summary:
Senator Wardner and Commissioner Rauschenberger called the meeting to order. Senator Wardner indicated the meeting is not an official meeting of a legislative committee or other formal committee. Commissioner Rauschenberger indicated the purpose of the meeting is to gather information regarding oil and gas valuation issues as they relate to taxation, royalty calculation and deductions from oil and gas royalties.

The Office of State Tax Commissioner distributed information regarding oil and gas gross production taxes, including an explanation of the tax base, tax rate, exemptions and amounts collected. The gross production tax on oil is levied at the rate of 5 percent on the gross value at the well. However, the gross production tax on natural gas is levied at a flat rate per thousand cubic feet (MCF). The rate is subject to an annual adjustment based on changes in the average producer price index for gas fuels. The current gas gross production tax rate for fiscal year 2018 is $.055 per MCF. For fiscal year 2017, the most recent complete fiscal year, the gross production tax on gas resulted in state collections of $33.3 million, compared to the gross production tax on oil which resulted in state collections of $733.2 million.

Department of Trust Lands Commissioner Lance Gaebe discussed the role of the department as mineral manager for the state of North Dakota's sovereign minerals. State sovereign minerals include those granted to the state at statehood, riverbed minerals, and those acquired through other means. Minerals held in trust are managed by the department through approximately 8,000 mineral leases; the resulting revenues are deposited into 18 different funds managed by the department for designated purposes or beneficiaries. Mr. Gaebe said, as a manager of the state's mineral interests, his department must interpret royalty statements in the same way as a private mineral owner.

In response to a question from Mr. Lloyd Ness, Mr. Gaebe indicated under the state's standard lease the state royalty is based on the gross value at the point of sale, through an arm's-length transaction, with no deductions. He said although those terms are standard for mineral leases with the state, there are many different provisions used in private mineral leases. The specific provisions included in a private lease depend upon the lease terms proposed by the leasing company and the final terms negotiated with the owner.

In response to a question from Mr. Skarphol, Mr. Gaebe said for mineral royalty purposes, the term "arm's-length transaction" is not defined in statute. However, the term is defined in administrative rules adopted by the North Dakota Industrial Commission. He said it can be very difficult to define exactly what constitutes an arm's-length transaction when the parties involved are related entities, especially when dealing with the various parties involved in gas gathering and processing.

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Office of State Tax Commissioner General Counsel Dee Wald indicated that for tax purposes, "arm's-length transaction" is defined in statute and excludes transactions between related entities. Commissioner Rauschenberger noted that to determine oil valuation for tax purposes, the Office of State Tax Commissioner can examine similar transactions if the oil being valued was sold under something other than an arm's-length contract.

Mr. Lloyd Ness discussed the relationship between the value of gas and the costs incurred to gather the gas. He indicated private mineral owners are receiving royalty statements showing deductions for the costs of gas gathering that exceed the value of the gas. He said the resulting negative value is being deducted from oil royalties. He said in some cases, the gathering costs are three to four times the value of the gas. Mr. Gaebe indicated in the case of state royalties, his department has only seen a couple of instances where a negative gas royalty amount offset oil royalties. In each case, he said the producer was informed that such an offset is not allowed pursuant to the state lease agreement and the royalty amount was adjusted. Mr. Skarphol encouraged Mr. Gaebe to do a thorough examination of state royalties to ensure the state is not losing money due to inappropriate deductions relating to gas gathering costs. He said specific attention should be paid to any state leases in the Beaver Lodge Unit.

Director of Mineral Resources Lynn Helms, North Dakota Department of Mineral Resources, discussed a proposed change to North Dakota Administrative Code Section 43-02-06-01, relating to royalty statements. The proposed change would require each royalty statement to include the amount and purpose of each deduction or adjustment made, including transportation, processing, compression, utilities and administrative costs. The rule would also require royalty statements to indicate the point of sale for oil, gas and natural gas liquids, as well as the gross and net mineral acres in the spacing unit. Mr. Helms said under the current rule, royalty owners are often not provided an explanation of the deductions, point of sale or mineral acres. He said the Department of Mineral Resources will be accepting comments on the proposed rule through October 23, 2017. He distributed a handout with several articles relating to the deductibility of post-production costs and related issues that have resulted in litigation in Texas and Pennsylvania.

Mr. Lloyd Ness displayed a PowerPoint presentation and discussed his concerns as a royalty owner. A copy of the PowerPoint presentation was not provided. He discussed concerns regarding what he views as excessive gas gathering costs that exceed the value of the gas and result in an offset to oil royalties. He also discussed an ongoing legal dispute between himself and Sampson Oil and Gas Limited. He expressed concern regarding what he understood to be an inappropriate agreement between Sampson Oil and Gas Limited and ONEOK where contracts between the two companies provide for, what he described as, volume credit provisions that allow Sampson to receive a reduced fee if volume quotas are reached. He indicated his belief that resulting credits were not passed on to royalty owners to reduce the costs they were being charged.

Mr. Skarphol expressed concerns with what he viewed as excessive deductions to royalties paid by Hess Corporation. Mr. Lloyd Ness said there is no place for royalty owners to go with questions or concerns regarding royalty statements and the terms of individual leases are not being honored by companies. He suggested that royalty owners have some representation on the North Dakota Industrial Commission. Mr. Helms said such a change would require legislative action.

Senator Wardner and Commissioner Rauschenberger thanked the attendees for participating in the meeting and sharing information and their concerns. Commissioner Rauschenberger said the information presented will be considered as the decision is made regarding how the proposed study of oil and gas valuation issues should proceed.

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OIL & GAS VALUATION STUDY MEETING MINUTES
NOVEMBER 1, 2017

Persons in Attendance:
Senator Rich Wardner; Tax Commissioner Ryan Rauschenberger, Joe Morrissette, Dee Wald, Ken Herman, Kathy Strombeck, Office of State Tax Commissioner; Brady Pelton, North Dakota Petroleum Council; Stephen Kuchel, Troy Sanstra, Danette Odenbach-Welsch, ONEOK Partners.

Meeting Summary:
Senator Wardner and Commissioner Rauschenberger called the meeting to order.

Mr. Kuchel provided a presentation on ONEOK's gas gathering and processing operations in the Williston Basin. Mr. Kuchel said gathering and processing natural gas in the Williston Basin requires a large investment due to the wet gas and extreme weather environment. He said because of the extreme environment, costs in the Williston Basin are higher than either Oklahoma or Texas. He said ONEOK has invested $3 billion in North Dakota for gathering, compression and processing infrastructure to capture natural gas, partly in response to North Dakota Industrial Commission regulations that require a reduction in flaring of natural gas. Mr. Kuchel said from 2010 to 2017, ONEOK has built seven new gas processing plants, constructed an average of 500 miles of pipeline per year, and built 22 new compressor stations.

In response to a question from Senator Wardner, Mr. Kuchel indicated it is possible some wells would have been forced to stop production if it were not for the gas capture capacity that resulted from ONEOK's investment.

In response to a question from Commissioner Rauschenberger, Mr. Kuchel said ONEOK infrastructure typically starts at the gas meter on the oil production site. He said produced fluids go through a separator and heater treater to separate oil, gas and water and create a separate gas stream. Once the gas is separated, it is collected in their gathering lines for processing. He said their gathering system covers about 50 percent of the production in North Dakota.

Mr. Sanstra continued the presentation and discussed various gas purchase contract provisions. Mr. Sanstra said midstream gathering and processing companies, like ONEOK Rockies Midstream, generally take title to gas after it is separated at the wellhead. He said midstream companies do not pay royalties. Producers enter into lease agreements with mineral owners and the producers pay royalties based on the terms of the lease. Contracts to purchase gas are negotiated between producers and midstream companies. Contracts include negotiated provisions that may include the timing of connecting wells to the system, the required volume of gas, and the quality of gas produced. Contract rates are determined based on many factors, including capital requirements, operating expenses, gas quality, expected volumes, contract term and expected gas prices. Mr. Sanstra said the three major types of contracts are: percent of proceeds, percent of proceeds with fees, and fee-based. He said a percent of proceeds with fees contract allows the midstream company to retain a portion of the proceeds from the sale of the natural gas liquids and residue gas, and provides for the producer and midstream company to share the impact of price changes. In a fee-based contract, the midstream company is paid a fee per thousand cubic feet (MCF) of gas for its services and the producer takes all of the risk from fluctuating prices.

In response to a question from Senator Wardner, Mr. Sanstra indicated that if a minimum price is specified in the contract, the producer could be required to pay the midstream company to take and process the gas if market price falls below the minimum.

In response to a question from Senator Wardner, Mr. Sanstra said a contract may specify a minimum volume requirement, as is the case with certain ONEOK contracts in Divide County. He said the minimum volume requirement is typically not specified in terms of a monthly requirement, but is more often a requirement to be met over several years. Mr. Sanstra said contracts with minimum volume requirement may allow for volume credits to be provided to producers who were original parties to the contract. Volume credits may result when additional producers are added to the system. When production from other producers, who were not part of the original contract, is added to the system, the additional production results in a reduction in the volume required from the original producers.

Senator Wardner and Commissioner Rauschenberger thanked the attendees for participating in the meeting and sharing information. Commissioner Rauschenberger said the information presented will be considered as the decision is made regarding how the proposed study of oil and gas valuation issues should proceed.

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Oil & Gas Valuation Study Meeting Minutes
February 1, 2018

Persons in Attendance:
Senator Rich Wardner; Tax Commissioner Ryan Rauschenberger, Joe Morrissette, Dee Wald, Ken Herman, Kathy Strombeck, Office of State Tax Commissioner; Ron Ness, North Dakota Petroleum Council; Rick Ross, Mike Stevens, Whiting Petroleum Corporation.

Meeting Summary:
Senator Wardner and Commissioner Rauschenberger called the meeting to order.

Senator Wardner provided background information on the legislative history of the study and the information that has been discussed in previous meetings. He asked the representatives from Whiting to let the group know if there are pieces of information missing as the group tries to gain a better understanding the various issues relating to oil and gas valuation and the mineral owner concerns that prompted the study legislation.

Senator Wardner provided a handout (Attachment A) summarizing his understanding of a typical gas gathering and processing system. He noted that a contract exists between the mineral owner and the producer and a separate contract exists between the producer and the midstream gas processing company. He stated his understanding that the contract between the producer and the processor govern the allocation of gas revenues as well as charges for costs incurred in developing infrastructure and processing gas streams.

Mr. Ness said there will be a need for significant investment in gas gathering and processing infrastructure as gas production continues to grow in North Dakota. He suggested Justin Kringstad from the North Dakota Pipeline Authority be invited to present information on future infrastructure needs and the associated costs.

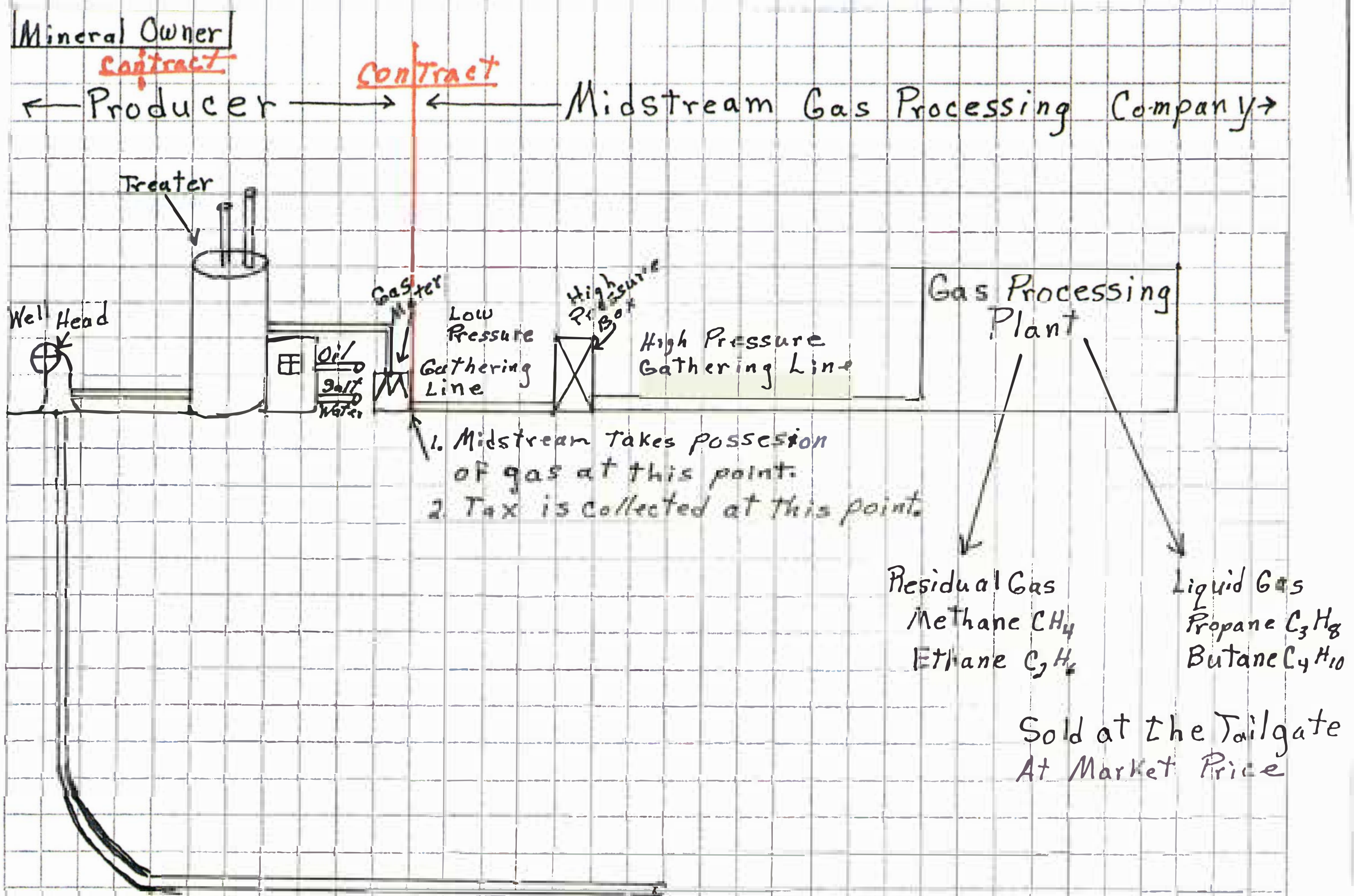
Mr. Herman said the gas purchaser typically remits the North Dakota gas tax. Producers typically only remit tax for certain uses, such as on-lease use of gas.

Mr. Ross discussed the mix of gases that are recovered along with natural gas and the various processing methods used to separate the gas components into marketable products. He said all revenues from the sale of the gas must be allocated based on contractual agreements between the operators and the gas processors.

Mr. Stevens distributed an example of a royalty statement (Attachment B) issued by Whiting and explained the revenues, deductions, and allocations. He noted that all deductions are listed separately and are explained for the royalty owner. The specific deductions are governed by the terms of the contract in place between the producer and Whiting.

Senator Wardner and Commissioner Rauschenberger thanked the attendees for participating in the meeting and sharing information. Commissioner Rauschenberger said the information presented will be considered as the decision is made regarding how the proposed study of oil and gas valuation issues should proceed.

Gas Processing Diagram



Attachment A

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CHAPTER 43-02-06
ROYALTY STATEMENTS

43-02-06-01. Royalty owner information statement. (Effective through June 30, 2019)

Whenever payment is made for oil or gas production to an interest owner, whether pursuant to a division order, lease, servitude, or other agreement, all of the following information must be included on the check stub or on an attachment to the form of payment, unless the information is otherwise provided on a regular monthly basis:

1. The lease, property, or well name or any lease, property, or well identification number used to identify the lease, property, or well; provided, that if a lease, property, or well identification number is used the royalty owner must initially be provided with the lease, property, or well name to which the lease, property, or well name refers.

2. The month and year during which sales occurred for which payment is being made.

3. One hundred percent of the corrected volume of oil, regardless of ownership, which is sold measured in barrels, and one hundred percent of the volume of either wet or dry gas, regardless of ownership, which is sold or removed from the premises for the purpose of sale, or sale of its contents and residue, measured in thousand cubic feet.

4. Price.

    a. Oil. Weighted average price per barrel received by the producer for all oil sold during the period for which payment is made. The price would be the net price received by the producer after purchaser's deductions. The purchaser's deductions are to be explained pursuant to subsection 6.

    b. Gas. Weighted average price per thousand cubic feet [28.32 cubic meters] received by the producer for all gas sold during the period for which payment is made. The price would be the net price received by the producer after purchaser's deductions. The purchaser's deductions are to be explained pursuant to subsection 6.

5. Total amount of state severance and other production taxes.

6. Any other deductions or adjustments. Those not explained on the statement or in a separate mailing must be explained to the royalty owner upon inquiry to the disburser.

7. Net value of total sales after deductions.

8. Owner's interest in sales from the lease, property, or well expressed as a decimal.

9. Owner's share of the total value of sales prior to any tax deductions.

10. Owner's share of sales value less deductions.

11. 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.

2/12 SCR 4010 #3 pg.12

Royalty owner information statement. (Effective July 1, 2019) Whenever payment is made for oil or gas production to an interest owner, whether pursuant to a division order, lease, servitude, or other agreement, all of the following information must be included on the check stub or on an attachment to the form of payment, unless the information is otherwise provided on a regular monthly basis:

1. The lease, property, or well name or any lease, property, or well identification number used to identify the lease, property, or well; provided, that if a lease, property, or well identification number is used, the royalty owner must initially be provided the lease, property, or well name to which the lease, property, or well name refers.
2. The month and year during which sales occurred for which payment is being made.
3. One hundred percent of the corrected volume of oil, regardless of ownership, which is sold measured in barrels, and one hundred percent of the volume of either wet or dry gas, regardless of ownership, which is sold or removed from the premises for the purpose of sale, or sale of its contents and residue, measured in thousand cubic feet.
4. Price.
    a. Oil. Weighted average price per barrel received by the producer for all oil sold during the period for which payment is made. The price must be the net price received by the producer after all deductions. All deductions are to be explained pursuant to subsection 6.
    b. Gas and natural gas liquids. Weighted average price per thousand cubic feet [28.32 cubic meters] received by the producer for all gas sold and weighted average price per gallon received by the producer for all natural gas liquids sold during the period for which payment is made. The price must be the net price received by the producer after all deductions. All deductions are to be explained pursuant to subsection 6.
5. Total amount of state severance and other production taxes.
6. The amount and purpose of each deduction made, identified as transportation, processing, compression, or administrative costs.
7. The amount and purpose of each adjustment or correction made.
8. Net value of total sales after deductions.
9. Owner's interest in sales from the lease, property, or well expressed as a decimal.
10. Owner's share of the total value of sales prior to any tax deductions.
11. Owner's share of sales value less deductions.
12. 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.

History: Effective November 1, 1983; amended effective April 1, 1984; November 1, 1987; May 1, 1992; April 1, 2018.
General Authority: NDCC 38-08-06.3
Law Implemented: NDCC 38-08-06.3

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43-02-06-01.1. Ownership interest information statement. (Effective July 1, 2019)

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, 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 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.

History: Effective April 1, 2018.
General Authority: NDCC 38-08-06.3
Law Implemented: NDCC 38-08-06.3

43-02-06-02. Annual windfall profits tax information statement.

Repealed effective May 1, 1992.

43-02-06-03. Annual stored gas information statement.

Any person required to submit information, as provided by this chapter, to a royalty owner shall, if gas either wholly or partially owned by a royalty owner is being placed into storage off the leased premises, provide the royalty owner with an annual statement containing the following information:

1. Total corrected volume of gas measured in standard thousand cubic feet (MCF) in storage at the beginning of the calendar year;
2. Total corrected volume of gas measured in thousand cubic feet added each month to storage during the calendar year;
3. Total corrected volume of gas measured in thousand cubic feet removed each month from storage during the calendar year; and
4. Total corrected volume of gas measured in thousand cubic feet in storage at the end of the calendar year.

The information required by this section must be supplied for all royalty owner gas placed into storage after December 31, 1986, and must be mailed to the royalty owner annually no later than March thirty-first immediately following each calendar year covered by the statement.

History: Effective November 1, 1987; amended effective May 1, 1992.
General Authority: NDCC 38-08-06.3
Law Implemented: NDCC 38-08-06.3

43-02-06-04. Books and records to be kept to substantiate reports.

All operators shall make and keep appropriate books and records for a period of not less than six years, covering their operations in North Dakota from which they may be able to make and substantiate the reports required by this chapter.

History: Effective September 1, 2000.
General Authority: NDCC 38-08-06.3
Law Implemented: NDCC 38-08-06.3

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OIL & GAS VALUATION STUDY CONCLUSION

Based on the input from the various stakeholder discussions and the review of private oil and gas royalty lease contracts, we recommend no statutory changes to the following:

- how natural gas or oil is valued for private party royalty purposes
- how natural gas or oil is valued for tax purposes
- how natural gas gathering and processing costs are deducted from distributions to private royalty owners

Our recommendation is based on the following considerations:

- Oil and gas royalty contracts are agreements between two or more private parties.
- The judicial system is in place to address contractual disputes between the oil producers and the royalty owners with regards to which deductions are allowed and which deductions are not allowed.
- The industrial commission has made some regulatory changes to improve the disclosure of deductions and adjustments on royalty statements. These changes have been in place since this study was adopted last year. We have attached the rule for you to review on pages 9 through 11 of this report.

The current rule stipulates that a royalty statement must disclose "Any other deductions or adjustments. Those not explained on the statement or in a separate mailing must be explained to the royalty owner upon inquiry to the disburser."

The new disclosure rule, which becomes effective July 1, 2019, greatly enhances the requirement for disclosure stating, "The amount and purpose of each deduction made, identified as transportation, processing, compression, or administrative costs."

The Industrial Commission is working with the North Dakota Petroleum Council on determining what disclosures will be sufficient to meet the new requirements.

Although the royalty disclosure requirements may not solve all of the issues royalty owners have, it is a step in the right direction.

For the purpose of this study we support the Industrial Commission's efforts to continue working with the industry to improve transparency for the royalty owners.

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House Finance and Tax Committee. **March 6, 2019**
Honorable Representative Craig Headland, Chairman
Senate Concurrent Resolution 4010
Testimony by Senator Brad Bekkedahl

Chairman Headland and Committee members,

SCR 4010 is a study resolution to look at post-production deductions. As the name indicates, there is a practice among oil and gas operators in North Dakota to deduct costs for oil/gas gathering, transportation, compression, treating, processing, and marketing. The issue of the amount of deductions occurring was first brought to our attention in the 2017 legislative session but was not addressed formally in any way. In the 2017-19 Interim, the Energy Development and Transmission Committee informally looked at the issue after concerns expressed by many royalty interest owners in the State. While the industry maintains they are following all law and statute and have authority in the individual lease agreements signed by the royalty interest owners to assess post-production deductions, there has continued to be complaints from royalty owners to the state and legislators. There is currently an association of royalty owners in North Dakota forming to be more organized in the effort to address this issue. This history and discussions among Legislators led to the introduction of this study resolution for consideration by Legislative Management in the 2019-21 Interim. It should be noted also that the State, which has very large royalty interests has also been incurring post-production deductions on some of its holdings and is responding to litigation in its attempts to recover these deductions, which are prohibited by language in most of the leases the State holds now.

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Mr. Chairman, this issue is not solely in North Dakota. Other oil and gas producing states have taken an interest in looking at these deduction practices as well, with some states introducing and passing legislation limiting or prohibiting the practice. The ones that have passed bills are in litigation at this time, so the study may give some insight as to what has happened elsewhere, and what, if anything should be addressed here in North Dakota. As you can see, the study is designed to get representation from all the parties interested, including the oil and gas industry, royalty owners, the department of mineral resources, the department of trust lands, the attorney general's office, and other state agencies. And the industry has been extremely cooperative in working with individual legislators and committees, particularly as it relates to the new royalty statements required by the Industrial Commission to provide further clarification and transparency to the owners. It is hoped this study will be comprehensive enough to bring resolution either by better understanding the practice of post-production deductions or looking at best practices on behalf of royalty interest owners.

I am including a few copies of different royalty statements for the committee to see how the deductions are noted in some company's correspondence to royalty owners. I appreciate the committee's consideration of SCR 4010 and will stand for any questions.

8009080

OASIS PETROLEUM - ROYALTY
1001 FANNIN, SUITE 1500
HOUSTON, TX 77002
855-209-8370

#1
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3-6-19
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Payee No	Payee Name	Check Date	Check Number	Check Total
[redacted]	[redacted]	12/28/2018	0000654151	$*********225.18

WELL# / SALE DATE	PC	TYP INT	UNIT VALUE	QUANTITY	VALUE	GROSS DEDUCTIONS	NET	OWNER INTEREST	PAID INT	OWNER VALUE	OWNER DEDUCTIONS	NET SHARE
P17182.1			OSPREY 5401 44-23H			NDWilliams	Section: 14 Township: 154-N Range: 101-W					
10/18	GAS	WU	6.38	21391.53	136417.76	108776.32 CMG	25377.46	0.00037086	0.00037086	50.59	40.93 CMG	8.81
						2263.98 ND_SEV					0.85 ND_SEV	
11/18	OIL	WU	49.32	15009.79	740354.95	32486.64 ND_MET	584759.60	0.00037086	0.00037086	274.57	12.05 ND_MET	216.37
						32486.64 ND_SEV					12.05 ND_SEV	
						90622.07 TRN					34.10 TRN	

	OWNER GROSS	OTHER ADJUSTMENTS	OWNER NET DEDUCTIONS	OWNER NET TOTALS
CURRENT CHECK	325.16	0.00	99.98	225.18

---------PRODUCTS/DEDUCTIONS---------

CMG - COMPRESSION, GATHERING, & TREAT/ ND_SEV - SEVERANCE TAX/ ND_MET - ND MINERAL EXTRACTION TAX/ TRN - TRANSPORTATION/

Note to Royalty Interest Owners: The amount(s) in the "DEDUCTIONS" column may be greater than the amount in the "VALUE" column; however, the amount in the "NET" column will not be negative, as negative amounts are not being assessed against your royalty interest.

TOTAL CHECK AMOUNT 225.18

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[redacted]

ER # 17492001

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Toll Free 1-844-275-4377
http://ownerrelations.hess.com

CHECK NUMBER E009142599
CHECK AMOUNT 1,208.97
CHECK DATE 1/25/19

PROP/ST/CTY		GROSS INTEREST							OWNER INTEREST					
PROD MNTH	PROD CODE	TX	GROSS VOLUME	$ PRICE	$ GROSS VALUE	$ TAXES	$OTHER DEDUCTION	$ NET VALUE	DISB. DECIMAL	INT TYPE	$ GROSS VALUE	$ TAXES	$OTHER DEDUCTIONS	$ NET VALUE
									OWNER TOTAL		1,579.08	131.84	238.27	1,208.97

PRODUCT CODES: 1XX - OIL (BBLS) 2XX - GAS (MCF) 3XX - CONDENSATE (BBLS) 4XX - PLANT PRODUCTS (GALS) 9XX - JOINT VENTURE EXPENSES
TAX CODE (TX): 12 - STATE INCOME TAX WITHHOLDING

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CONTINENTAL RESOURCES, INC
OKLAHOMA CITY, OK 73126 (405) 774-5257

Owner No.	Check No.	Check Date
21054203	E100932642	01/28/2019

Product Code	Interest Types		Deduct Codes			Other Adjustment Codes
O - Oil	WI - Working Interest	MI - Unleased Mineral Int	CO - Compression	PR - Processing	TR - Transportation	IN - Interest Paid
G - Gas	WR - Working Other	OW - Override Working Int	GA - Gathering	MK - Marketing Fee	OT - Other	MS - Miscellaneous
	RI - Royalty Interest	OU - Override Unsigned	LF - Line Fill Fee	TG - Treating		SW - State (Income Tax) Withholding
	RU - Royalty Unsigned	OR - Overriding Royalty				

Property Number/DOI Number/Name — County, State

Prod Date	Prod Code	BTU Factor	Int Type	Record Decimal	Disb Decimal	Price	Gross Information: Volume	Gr Value	Taxes	Deducts	Net Amt	Owner Information: Volume	Gr Value	Taxes	Deducts	Code	Net Amt
										-551.00						GA	
										-842.25					-0.82	LF	
12/18	O		RI01	0.00097656	0.00097656	34.24	8,009.57	274,226.85	-27,422.68	-671.20	246,132.97	7.82	267.80	-26.78	-0.38		240.64
										-282.74						GA	
										-388.46					-0.38	LF	
12/18	O		RI02	0.00097656	0.00097656	34.24	8,009.57	274,226.85	-27,422.68	-671.20	246,132.97	7.82	267.80	-26.78	-0.38		240.64
										-282.74						GA	
										-388.46					-0.38	LF	
09/18	G	1.539	RI01	0.00097656	0.00097656	3.27	14,891.00	48,650.37	-1,101.45		47,548.92	14.54	47.51	-1.08			46.43
09/18	G	1.539	RI02	0.00097656	0.00097656	3.27	14,891.00	48,650.37	-1,101.45		47,548.92	14.54	47.51	-1.08			46.43
10/18	G	1.486	RI01	0.00097656	0.00097656	3.10	29,144.00	90,440.83	-2,137.00		88,303.83	28.46	88.32	-2.09			86.23
10/18	G	1.486	RI02	0.00097656	0.00097656	3.10	29,144.00	90,440.83	-2,137.00		88,303.83	28.46	88.32	-2.09			86.23
11/18	G	1.536	RI01	0.00097656	0.00097656	2.33	27,862.00	65,004.55	-1,964.28		63,040.27	27.21	63.48	-1.92			61.56
11/18	G	1.536	RI02	0.00097656	0.00097656	2.33	27,862.00	65,004.55	-1,964.28		63,040.27	27.21	63.48	-1.92			61.56
			Property Totals:										7,035.12	-673.82	-8.02		6,353.28

OWNER TOTALS

	Gr Value	Taxes	Deducts	Net Amt
Total Before Other Adjustments:	13,927.52	-1,321.69	-15.96	12,589.87
Interest Paid:				0.00
Miscellaneous:				0.00
State (Income Tax) Withholding:				0.00
NRA/Backup (Income Tax) Withholding:				0.00
Owner Check Amount:				12,589.87

XTO Energy Inc.
110 West 7th Street
Fort Worth, TX 76102-7108

XTO ENERGY INC.
WHEN INQUIRING, REFER TO YOUR BP NO., PROPERTY DOI NO., CHECK DATE
1-866-886-2613 EMAIL: revenue_inquiry@xtoenergy.com
XTO ENERGY, INC. ACTING ON BEHALF OF ITSELF AND/OR ITS AFFILIATES

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[redacted]

*** * * STATEMENT DETAILS ENCLOSED * * ***

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Oil/Gas Payment Statement
SHOULD BE RETAINED FOR TAX PURPOSES

CHECK DATE	CHECK #	YOUR BP NO.	GROSS VALUE	TAXES	DEDUCTIONS	NET PAYMENT
01/25/2019	1000023145	30137027	$550.04	$39.96-	$150.22-	$359.86

XTO ENERGY INC. BELIEVES THAT THE PAYMENTS COVERED BY THIS CHECK HAVE BEEN CALCULATED APPROPRIATELY. HOWEVER, IF A MISTAKE IS IDENTIFIED THEN XTO ENERGY INC. MAY CORRECT THE PAYMENT. XTO ENERGY INC. DOES NOT WAIVE AND EXPLICITLY RESERVES ALL LEGAL RIGHTS, DEFENSES, AND CLAIMS PERTAINING TO ROYALTY UNDER THE APPLICABLE LEASE(S).

DETACH AND RETAIN THIS STUB FOR YOUR RECORDS

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PRODUCTION TYPE / DESCRIPTION / MEASUREMENT

CO2	CARBON DIOXIDE	MCF
CON	CONDENSATE	BARRELS
DRP	DRIP CONDENSATE	BARRELS
FLA	UPSTREAM FUEL	MCF
FLB	DOWNSTREAM FUEL	MCF
FLR	FLARE	MCF
GAS	NATURAL GAS	MCF
GML	GAS USED IN MANUFACTURE OF LIQUIDS	MCF
HEL	HELIUM	MCF
L&U	LOSS AND UNACCOUNTED FOR	MCF
LNG	LIQUEFIED NATURAL GAS	MCF
NGL	NATURAL GAS LIQUIDS	GALLONS
OIL	CRUDE OIL	BARRELS
RES	RESIDUE	MCF
SUL	SULPHUR	MCF

DEDUCTION TYPES

COM	COMPRESSION
DEH	DEHYDRATION
FLA	UPSTREAM FUEL
FLB	DOWNSTREAM FUEL
GAT	GATHERING
L&U	LOSS AND UNACCOUNTED FOR
MKT	MARKETING
OTH	OTHER
PRO	PROCESSING
RTU	ROYALTY TRUE UP
TRN	TRANSPORTATION
TRT	TREATING/CONDITIONING

INTEREST TYPES

OC	EXCESS ROYALTY
OR	OVERRIDING ROYALTY INTEREST
PP	PRODUCTION PAYMENT
RI	ROYALTY INTEREST
WI	WORKING INTEREST

TAX TYPES

ADV	AD VALOREM TAX
CA	CALIFORNIA STATE TAX WITHHOLDING
CO	COLORADO STATE MINERAL TAX WITHHOLDING
CON	CONSERVATION TAX
ENV	ENVIRONMENTAL TAX (CLEAN UP FEE)
FED	FEDERAL BACKUP TAX WITHHOLDING
IND	INDIAN TAX
MT	MONTANA STATE TAX WITHHOLDING
ND	NORTH DAKOTA STATE TAX WITHHOLDING
NM	NEW MEXICO STATE TAX WITHHOLDING
NRA	FEDERAL NON-RESIDENT ALIEN
OK	OKLAHOMA STATE TAX WITHHOLDING
PA	PENNSYLVANIA STATE TAX WITHHOLDING
SCH	SCHOOL TAX (NM)
SEV	SEVERANCE TAX
UT	UTAH STATE MINERAL TAX WITHHOLDING

OTHER PAYMENT TYPES

INT	INTEREST PAID
MIS	MISCELLANEOUS
SML	SETTLEMENT

CHECK STUB MESSAGES

HTTPS://WWW.XTOENERGY.COM/
- CLICK ON INTEREST OWNER RELATIONS LINK AT THE TOP
- VIEW AND PRINT CHECK AND PAYMENT HISTORY
- ACCESS DIRECT DEPOSIT, CHANGE OF ADDRESS, AND 1099 FORMS
- FIND ANSWERS TO FREQUENTLY ASKED QUESTIONS

FOR FURTHER INFORMATION PLEASE CONTACT US AT REVENUE_INQUIRY@XTOENERGY.COM

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APPENDIX M

2018 OIL AND GAS VALUATION STUDY

ND Tax
NORTH DAKOTA

RYAN RAUSCHENBERGER
TAX COMMISSIONER

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OIL & GAS VALUATION STUDY

Chapter 38 of the 2017 Laws of North Dakota (Session Laws):

SECTION 28. AMENDMENT. Section 21 of Senate Bill No. 2013 as approved by the sixty-fifth legislative assembly, is amended and reenacted as follows:

SECTION 21. STUDY OF OIL AND GAS VALUATION – REPORT TO ENERGY DEVELOPMENT AND TRANSMISSION COMMITTEE.

1. During the 2017 18 interim, the tax department, in consultation with the board of university and school lands, the industrial commission, and other state agencies as necessary, shall consider studying the valuation of oil and gas as used to determine mineral royalty payments and tax liability. The study must include consideration of the following:
   a. The methods used to calculate the value of oil and gas, including changes in custody, the basis for the value, any deductions or incentives applied to the value, and the point at which the value is determined.
   b. The impact of state and federal regulations, including gas capture requirements.
   c. The reporting of any deductions or incentives applied to the value as included on mineral royalty statements and tax reporting documents.
2. The tax department shall report to the energy development and transmission committee by September 30, 2018, regarding the results and recommendations of the study.

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Gross Production Tax on Natural Gas
Tax Base, Tax Rate, Exemptions and Collections

- The gross production tax on gas is an annually adjusted flat rate per thousand cubic feet (MCF) on all gas produced in the state that is not exempt
- The rate was established in HB 1098, 1991 Session, as $.04 per MCF – which was deemed fairly close to "revenue – neutral" when compared to the existing value based, 5% gross production tax rate
- The change from a value-based tax to a flat-rate tax on natural gas was a result of a collaborative effort between the Tax Department and the North Dakota Petroleum Council, to address on-going differences in gas valuation that were taking up valuable resources and resulting in costly litigation with very little "return" for either the industry or the state
- Procedures for annual rate adjustments were established in the 1991 legislation utilizing changes to the average producer price index for gas fuels, a method which is still used today
- Recent gross production tax rates for natural gas are as follows:
  - FY 2018 $.0550 (per MCF of gas produced)
  - FY 2017 $.0601
  - FY 2016 $.1106
  - FY 2015 $.0982
- Exemptions from the gross production tax on natural gas include:
  - Gas used on the lease for production purposes
  - Royalty interest from a federal, state, or municipal holding
  - An interest held by an organized Indian tribe
  - Gas that would otherwise be flared that is used in a generation unit to produce electricity for the well site
- Recent gross production tax collections on natural gas are as follows:
  - FY 2017 $33,275,164
  - FY 2016 $48,864,428
  - FY 2015 $32,959,075
  - FY 2014 $19,090,268

Gross Production Tax on Oil
Tax Base, Tax Rate, Exemptions and Collections

- The gross production tax on oil is levied at the rate of 5% of the gross value at the well
- The 5% rate was established in 1957, when it was increased from 4.25%
- The gross production tax is a real property tax, as codified by actions of the 1989 legislature
- In determining the gross value at the well for purposes of calculating the tax, costs associated with transporting the oil from the point of production to the point of sale are deductible
- Exemptions from the gross production tax on oil include:
  - Royalty interest in oil produced from a federal, state, or municipal holding
  - An interest held by an organized Indian tribe
- Recent gross production tax collections on oil are as follows:
  - FY 2017 $ 733,155,672
  - FY 2016 $ 701,610,076
  - FY 2015 $1,253,693,346
  - FY 2014 $1,473,892,184

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OIL & GAS VALUATION STUDY MEETING MINUTES
SEPTEMBER 12, 2017

Persons in Attendance:
Senator Rich Wardner, Lt. Governor Brent Sanford, Tax Commissioner Ryan Rauschenberger, Joe Morrissette, Dee Wald, Ken Herman, Kathy Strombeck, Office of State Commissioner; Ron Ness, Brady Pelton, North Dakota Petroleum Council; Lynn Helms, Department of Mineral Resources; Land Commissioner Lance Gaebe; Justin Kringstad, ND Pipeline Authority; Troy Seibel, Attorney General's Office; Taylor Lee, Bob Skarphol, Anne Skarphol, Lloyd Ness, Mary Ness, Matt Kelly.

Meeting Summary:
Senator Wardner and Commissioner Rauschenberger called the meeting to order. Senator Wardner indicated the meeting is not an official meeting of a legislative committee or other formal committee. Commissioner Rauschenberger indicated the purpose of the meeting is to gather information regarding oil and gas valuation issues as they relate to taxation, royalty calculation and deductions from oil and gas royalties.

The Office of State Tax Commissioner distributed information regarding oil and gas gross production taxes, including an explanation of the tax base, tax rate, exemptions and amounts collected. The gross production tax on oil is levied at the rate of 5 percent on the gross value at the well. However, the gross production tax on natural gas is levied at a flat rate per thousand cubic feet (MCF). The rate is subject to an annual adjustment based on changes in the average producer price index for gas fuels. The current gas gross production tax rate for fiscal year 2018 is $.055 per MCF. For fiscal year 2017, the most recent complete fiscal year, the gross production tax on gas resulted in state collections of $33.3 million, compared to the gross production tax on oil which resulted in state collections of $733.2 million.

Department of Trust Lands Commissioner Lance Gaebe discussed the role of the department as mineral manager for the state of North Dakota's sovereign minerals. State sovereign minerals include those granted to the state at statehood, riverbed minerals, and those acquired through other means. Minerals held in trust are managed by the department through approximately 8,000 mineral leases; the resulting revenues are deposited into 18 different funds managed by the department for designated purposes or beneficiaries. Mr. Gaebe said, as a manager of the state's mineral interests, his department must interpret royalty statements in the same way as a private mineral owner.

In response to a question from Mr. Lloyd Ness, Mr. Gaebe indicated under the state's standard lease the state royalty is based on the gross value at the point of sale, through an arm's-length transaction, with no deductions. He said although those terms are standard for mineral leases with the state, there are many different provisions used in private mineral leases. The specific provisions included in a private lease depend upon the lease terms proposed by the leasing company and the final terms negotiated with the owner.

In response to a question from Mr. Skarphol, Mr. Gaebe said for mineral royalty purposes, the term "arm's-length transaction" is not defined in statute. However, the term is defined in administrative rules adopted by the North Dakota Industrial Commission. He said it can be very difficult to define exactly what constitutes an arm's-length transaction when the parties involved are related entities, especially when dealing with the various parties involved in gas gathering and processing.

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Office of State Tax Commissioner General Counsel Dee Wald indicated that for tax purposes, "arm's-length transaction" is defined in statute and excludes transactions between related entities. Commissioner Rauschenberger noted that to determine oil valuation for tax purposes, the Office of State Tax Commissioner can examine similar transactions if the oil being valued was sold under something other than an arm's-length contract.

Mr. Lloyd Ness discussed the relationship between the value of gas and the costs incurred to gather the gas. He indicated private mineral owners are receiving royalty statements showing deductions for the costs of gas gathering that exceed the value of the gas. He said the resulting negative value is being deducted from oil royalties. He said in some cases, the gathering costs are three to four times the value of the gas. Mr. Gaebe indicated in the case of state royalties, his department has only seen a couple of instances where a negative gas royalty amount offset oil royalties. In each case, he said the producer was informed that such an offset is not allowed pursuant to the state lease agreement and the royalty amount was adjusted. Mr. Skarphol encouraged Mr. Gaebe to do a thorough examination of state royalties to ensure the state is not losing money due to inappropriate deductions relating to gas gathering costs. He said specific attention should be paid to any state leases in the Beaver Lodge Unit.

Director of Mineral Resources Lynn Helms, North Dakota Department of Mineral Resources, discussed a proposed change to North Dakota Administrative Code Section 43-02-06-01, relating to royalty statements. The proposed change would require each royalty statement to include the amount and purpose of each deduction or adjustment made, including transportation, processing, compression, utilities and administrative costs. The rule would also require royalty statements to indicate the point of sale for oil, gas and natural gas liquids, as well as the gross and net mineral acres in the spacing unit. Mr. Helms said under the current rule, royalty owners are often not provided an explanation of the deductions, point of sale or mineral acres. He said the Department of Mineral Resources will be accepting comments on the proposed rule through October 23, 2017. He distributed a handout with several articles relating to the deductibility of post-production costs and related issues that have resulted in litigation in Texas and Pennsylvania.

Mr. Lloyd Ness displayed a PowerPoint presentation and discussed his concerns as a royalty owner. A copy of the PowerPoint presentation was not provided. He discussed concerns regarding what he views as excessive gas gathering costs that exceed the value of the gas and result in an offset to oil royalties. He also discussed an ongoing legal dispute between himself and Sampson Oil and Gas Limited. He expressed concern regarding what he understood to be an inappropriate agreement between Sampson Oil and Gas Limited and ONEOK where contracts between the two companies provide for, what he described as, volume credit provisions that allow Sampson to receive a reduced fee if volume quotas are reached. He indicated his belief that resulting credits were not passed on to royalty owners to reduce the costs they were being charged.

Mr. Skarphol expressed concerns with what he viewed as excessive deductions to royalties paid by Hess Corporation. Mr. Lloyd Ness said there is no place for royalty owners to go with questions or concerns regarding royalty statements and the terms of individual leases are not being honored by companies. He suggested that royalty owners have some representation on the North Dakota Industrial Commission. Mr. Helms said such a change would require legislative action.

Senator Wardner and Commissioner Rauschenberger thanked the attendees for participating in the meeting and sharing information and their concerns. Commissioner Rauschenberger said the information presented will be considered as the decision is made regarding how the proposed study of oil and gas valuation issues should proceed.

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OIL & GAS VALUATION STUDY MEETING MINUTES
NOVEMBER 1, 2017

Persons in Attendance:
Senator Rich Wardner; Tax Commissioner Ryan Rauschenberger, Joe Morrissette, Dee Wald, Ken Herman, Kathy Strombeck, Office of State Tax Commissioner; Brady Pelton, North Dakota Petroleum Council; Stephen Kuchel, Troy Sanstra, Danette Odenbach-Welsch, ONEOK Partners.

Meeting Summary:
Senator Wardner and Commissioner Rauschenberger called the meeting to order.

Mr. Kuchel provided a presentation on ONEOK's gas gathering and processing operations in the Williston Basin. Mr. Kuchel said gathering and processing natural gas in the Williston Basin requires a large investment due to the wet gas and extreme weather environment. He said because of the extreme environment, costs in the Williston Basin are higher than either Oklahoma or Texas. He said ONEOK has invested $3 billion in North Dakota for gathering, compression and processing infrastructure to capture natural gas, partly in response to North Dakota Industrial Commission regulations that require a reduction in flaring of natural gas. Mr. Kuchel said from 2010 to 2017, ONEOK has built seven new gas processing plants, constructed an average of 500 miles of pipeline per year, and built 22 new compressor stations.

In response to a question from Senator Wardner, Mr. Kuchel indicated it is possible some wells would have been forced to stop production if it were not for the gas capture capacity that resulted from ONEOK's investment.

In response to a question from Commissioner Rauschenberger, Mr. Kuchel said ONEOK infrastructure typically starts at the gas meter on the oil production site. He said produced fluids go through a separator and heater treater to separate oil, gas and water and create a separate gas stream. Once the gas is separated, it is collected in their gathering lines for processing. He said their gathering system covers about 50 percent of the production in North Dakota.

Mr. Sanstra continued the presentation and discussed various gas purchase contract provisions. Mr. Sanstra said midstream gathering and processing companies, like ONEOK Rockies Midstream, generally take title to gas after it is separated at the wellhead. He said midstream companies do not pay royalties. Producers enter into lease agreements with mineral owners and the producers pay royalties based on the terms of the lease. Contracts to purchase gas are negotiated between producers and midstream companies. Contracts include negotiated provisions that may include the timing of connecting wells to the system, the required volume of gas, and the quality of gas produced. Contract rates are determined based on many factors, including capital requirements, operating expenses, gas quality, expected volumes, contract term and expected gas prices.
Mr. Sanstra said the three major types of contracts are: percent of proceeds, percent of proceeds with fees, and fee-based. He said a percent of proceeds with fees contract allows the midstream company to retain a portion of the proceeds from the sale of the natural gas liquids and residue gas, and provides for the producer and midstream company to share the impact of price changes. In a fee-based contract, the midstream company is paid a fee per thousand cubic feet (MCF) of gas for its services and the producer takes all of the risk from fluctuating prices.

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In response to a question from Senator Wardner, Mr. Sanstra indicated that if a minimum price is specified in the contract, the producer could be required to pay the midstream company to take and process the gas if market price falls below the minimum.

In response to a question from Senator Wardner, Mr. Sanstra said a contract may specify a minimum volume requirement, as is the case with certain ONEOK contracts in Divide County. He said the minimum volume requirement is typically not specified in terms of a monthly requirement, but is more often a requirement to be met over several years. Mr. Sanstra said contracts with minimum volume requirement may allow for volume credits to be provided to producers who were original parties to the contract. Volume credits may result when additional producers are added to the system. When production from other producers, who were not part of the original contract, is added to the system, the additional production results in a reduction in the volume required from the original producers.

Senator Wardner and Commissioner Rauschenberger thanked the attendees for participating in the meeting and sharing information. Commissioner Rauschenberger said the information presented will be considered as the decision is made regarding how the proposed study of oil and gas valuation issues should proceed.

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OIL & GAS VALUATION STUDY MEETING MINUTES
FEBRUARY 1, 2018

Persons in Attendance:
Senator Rich Wardner; Tax Commissioner Ryan Rauschenberger, Joe Morrissette, Dee Wald, Ken Herman, Kathy Strombeck, Office of State Tax Commissioner; Ron Ness, North Dakota Petroleum Council; Rick Ross, Mike Stevens, Whiting Petroleum Corporation.

Meeting Summary:
Senator Wardner and Commissioner Rauschenberger called the meeting to order.

Senator Wardner provided background information on the legislative history of the study and the information that has been discussed in previous meetings. He asked the representatives from Whiting to let the group know if there are pieces of information missing as the group tries to gain a better understanding the various issues relating to oil and gas valuation and the mineral owner concerns that prompted the study legislation.

Senator Wardner provided a handout (Attachment A) summarizing his understanding of a typical gas gathering and processing system. He noted that a contract exists between the mineral owner and the producer and a separate contract exists between the producer and the midstream gas processing company. He stated his understanding that the contract between the producer and the processor govern the allocation of gas revenues as well as charges for costs incurred in developing infrastructure and processing gas streams.

Mr. Ness said there will be a need for significant investment in gas gathering and processing infrastructure as gas production continues to grow in North Dakota. He suggested Justin Kringstad from the North Dakota Pipeline Authority be invited to present information on future infrastructure needs and the associated costs.

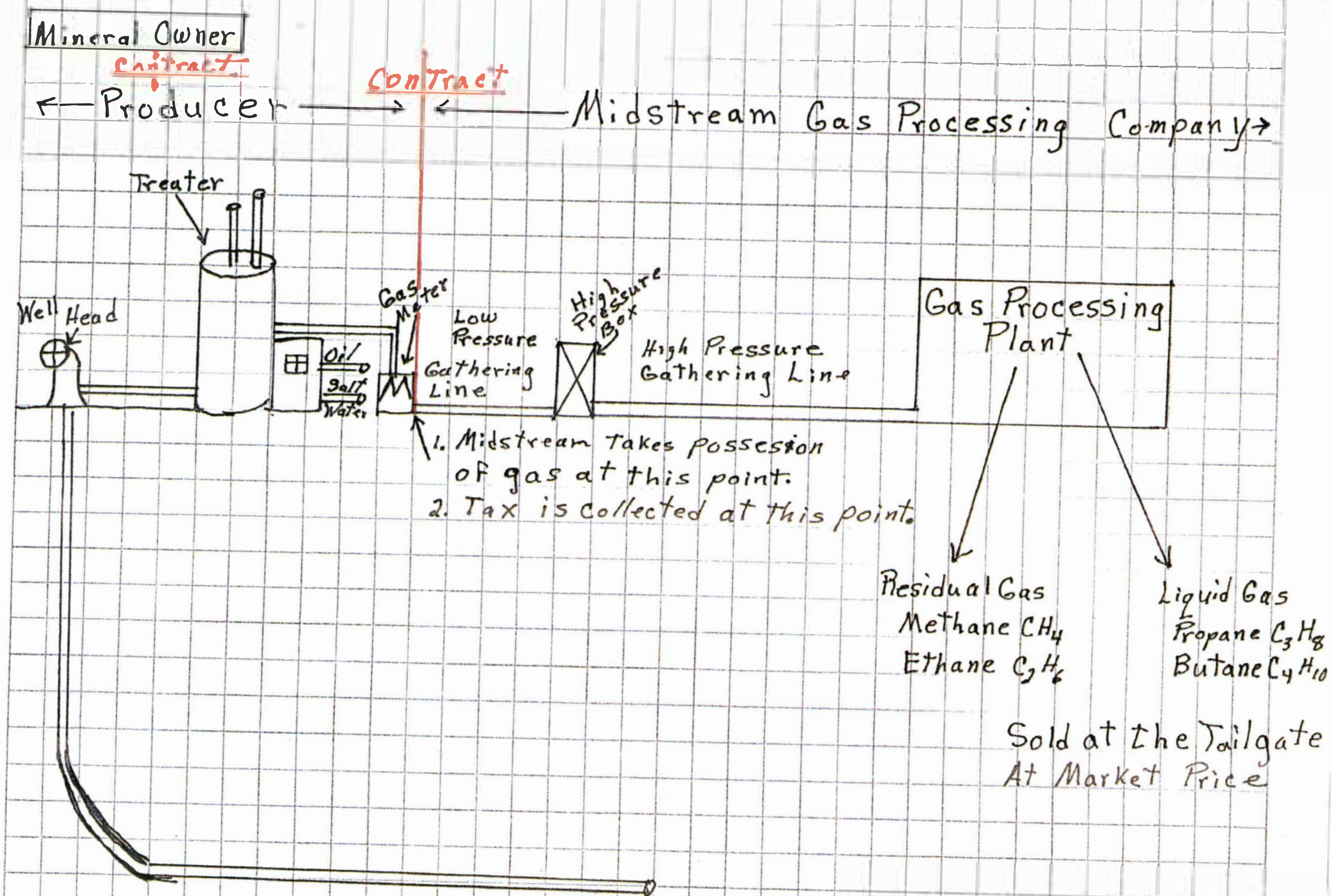
Mr. Herman said the gas purchaser typically remits the North Dakota gas tax. Producers typically only remit tax for certain uses, such as on-lease use of gas.

Mr. Ross discussed the mix of gases that are recovered along with natural gas and the various processing methods used to separate the gas components into marketable products. He said all revenues from the sale of the gas must be allocated based on contractual agreements between the operators and the gas processors.

Mr. Stevens distributed an example of a royalty statement (Attachment B) issued by Whiting and explained the revenues, deductions, and allocations. He noted that all deductions are listed separately and are explained for the royalty owner. The specific deductions are governed by the terms of the contract in place between the producer and Whiting.

Senator Wardner and Commissioner Rauschenberger thanked the attendees for participating in the meeting and sharing information. Commissioner Rauschenberger said the information presented will be considered as the decision is made regarding how the proposed study of oil and gas valuation issues should proceed.

Gas Processing Diagram



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Attachment A

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CHAPTER 43-02-06
ROYALTY STATEMENTS

Section

43-02-06-01. Royalty owner information statement. (Effective through June 30, 2019)

Whenever payment is made for oil or gas production to an interest owner, whether pursuant to a division order, lease, servitude, or other agreement, all of the following information must be included on the check stub or on an attachment to the form of payment, unless the information is otherwise provided on a regular monthly basis:

1. The lease, property, or well name or any lease, property, or well identification number used to identify the lease, property, or well; provided, that if a lease, property, or well identification number is used the royalty owner must initially be provided with the lease, property, or well name to which the lease, property, or well name refers.
2. The month and year during which sales occurred for which payment is being made.
3. One hundred percent of the corrected volume of oil, regardless of ownership, which is sold measured in barrels, and one hundred percent of the volume of either wet or dry gas, regardless of ownership, which is sold or removed from the premises for the purpose of sale, or sale of its contents and residue, measured in thousand cubic feet.
4. Price.
    a. Oil. Weighted average price per barrel received by the producer for all oil sold during the period for which payment is made. The price would be the net price received by the producer after purchaser's deductions. The purchaser's deductions are to be explained pursuant to subsection 6.
    b. Gas. Weighted average price per thousand cubic feet [28.32 cubic meters] received by the producer for all gas sold during the period for which payment is made. The price would be the net price received by the producer after purchaser's deductions. The purchaser's deductions are to be explained pursuant to subsection 6.
5. Total amount of state severance and other production taxes.
6. Any other deductions or adjustments. Those not explained on the statement or in a separate mailing must be explained to the royalty owner upon inquiry to the disburser.
7. Net value of total sales after deductions.
8. Owner's interest in sales from the lease, property, or well expressed as a decimal.
9. Owner's share of the total value of sales prior to any tax deductions.
10. Owner's share of sales value less deductions.
11. 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.

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Royalty owner information statement. (Effective July 1, 2019) Whenever payment is made for oil or gas production to an interest owner, whether pursuant to a division order, lease, servitude, or other agreement, all of the following information must be included on the check stub or on an attachment to the form of payment, unless the information is otherwise provided on a regular monthly basis:

1. The lease, property, or well name or any lease, property, or well identification number used to identify the lease, property, or well; provided, that if a lease, property, or well identification number is used, the royalty owner must initially be provided the lease, property, or well name to which the lease, property, or well name refers.

2. The month and year during which sales occurred for which payment is being made.

3. One hundred percent of the corrected volume of oil, regardless of ownership, which is sold measured in barrels, and one hundred percent of the volume of either wet or dry gas, regardless of ownership, which is sold or removed from the premises for the purpose of sale, or sale of its contents and residue, measured in thousand cubic feet.

4. Price.

   a. Oil. Weighted average price per barrel received by the producer for all oil sold during the period for which payment is made. The price must be the net price received by the producer after all deductions. All deductions are to be explained pursuant to subsection 6.

   b. Gas and natural gas liquids. Weighted average price per thousand cubic feet [28.32 cubic meters] received by the producer for all gas sold and weighted average price per gallon received by the producer for all natural gas liquids sold during the period for which payment is made. The price must be the net price received by the producer after all deductions. All deductions are to be explained pursuant to subsection 6.

5. Total amount of state severance and other production taxes.

6. The amount and purpose of each deduction made, identified as transportation, processing, compression, or administrative costs.

7. The amount and purpose of each adjustment or correction made.

8. Net value of total sales after deductions.

9. Owner's interest in sales from the lease, property, or well expressed as a decimal.

10. Owner's share of the total value of sales prior to any tax deductions.

11. Owner's share of sales value less deductions.

12. 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.

History: Effective November 1, 1983; amended effective April 1, 1984; November 1, 1987; May 1, 1992; April 1, 2018.
General Authority: NDCC 38-08-06.3
Law Implemented: NDCC 38-08-06.3

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43-02-06-01.1. Ownership interest information statement. (Effective July 1, 2019)

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, 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 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.

History: Effective April 1, 2018.
General Authority: NDCC 38-08-06.3
Law Implemented: NDCC 38-08-06.3

43-02-06-02. Annual windfall profits tax information statement.

Repealed effective May 1, 1992.

43-02-06-03. Annual stored gas information statement.

Any person required to submit information, as provided by this chapter, to a royalty owner shall, if gas either wholly or partially owned by a royalty owner is being placed into storage off the leased premises, provide the royalty owner with an annual statement containing the following information:

1. Total corrected volume of gas measured in standard thousand cubic feet (MCF) in storage at the beginning of the calendar year;

2. Total corrected volume of gas measured in thousand cubic feet added each month to storage during the calendar year;

3. Total corrected volume of gas measured in thousand cubic feet removed each month from storage during the calendar year; and

4. Total corrected volume of gas measured in thousand cubic feet in storage at the end of the calendar year.

The information required by this section must be supplied for all royalty owner gas placed into storage after December 31, 1986, and must be mailed to the royalty owner annually no later than March thirty-first immediately following each calendar year covered by the statement.

History: Effective November 1, 1987; amended effective May 1, 1992.
General Authority: NDCC 38-08-06.3
Law Implemented: NDCC 38-08-06.3

43-02-06-04. Books and records to be kept to substantiate reports.

All operators shall make and keep appropriate books and records for a period of not less than six years, covering their operations in North Dakota from which they may be able to make and substantiate the reports required by this chapter.

History: Effective September 1, 2000.
General Authority: NDCC 38-08-06.3
Law Implemented: NDCC 38-08-06.3

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Oil & Gas Valuation Study Conclusion

Based on the input from the various stakeholder discussions and the review of private oil and gas royalty lease contracts, we recommend no statutory changes to the following:

- how natural gas or oil is valued for private party royalty purposes
- how natural gas or oil is valued for tax purposes
- how natural gas gathering and processing costs are deducted from distributions to private royalty owners

Our recommendation is based on the following considerations:

- Oil and gas royalty contracts are agreements between two or more private parties.
- The judicial system is in place to address contractual disputes between the oil producers and the royalty owners with regards to which deductions are allowed and which deductions are not allowed.
- The industrial commission has made some regulatory changes to improve the disclosure of deductions and adjustments on royalty statements. These changes have been in place since this study was adopted last year. We have attached the rule for you to review on pages 9 through 11 of this report.

The current rule stipulates that a royalty statement must disclose "Any other deductions or adjustments. Those not explained on the statement or in a separate mailing must be explained to the royalty owner upon inquiry to the disburser."

The new disclosure rule, which becomes effective July 1, 2019, greatly enhances the requirement for disclosure stating, "The amount and purpose of each deduction made, identified as transportation, processing, compression, or administrative costs."

The Industrial Commission is working with the North Dakota Petroleum Council on determining what disclosures will be sufficient to meet the new requirements.

Although the royalty disclosure requirements may not solve all of the issues royalty owners have, it is a step in the right direction.

For the purpose of this study we support the Industrial Commission's efforts to continue working with the industry to improve transparency for the royalty owners.