Biennial Report on the Implementation of the Oil and Gas Tax Agreement with Three Affiliated Tribes

Oct. 8, 2012

The State's Oil and Gas Tax Agreement with the Three Affiliated Tribes has been a great success in terms of providing a stable, predictable tax environment in order to encourage development of the oil and gas resources within the reservation boundaries.

Background.

This biennial report is provided pursuant to Section 57-51.2-04, N.D.C.C., which directs the governor to "file biennial reports with the legislative council describing the agreement's implementation and any difficulties in its implementation."

Prior to the July 1, 2008, effective date of the agreement, there was very little oil and gas development within the reservation boundaries. Although the Fort Berthold Reservation lies in the heart of the Bakken field, only one Bakken horizontal well had been drilled within the reservation. In contrast, The Oil and Gas Divisions statistics show 598 Bakken wells were in production outside the reservation at that time. As of July, 2012, there were 4,319 Bakken wells in production and 436 of these are Bakken wells drilled within Fort Berthold since the agreement.

The tax agreement specifies that tax revenue must be divided evenly between the state and the tribe for production attributable to trust lands. Production from non-trust lands must be divided so that the tribe receives twenty percent and the state receives the remaining eighty percent. This division of production and extraction taxes is required by Chapter 57-51.2 of the North Dakota Century Code.

Current Trends.

Of the wells drilled since the agreement went into effect, 86 wells (18%) are on trust lands and the remaining 388 (82%) are on fee lands. The trend going forward is toward a much higher percentage of wells within the reservation being drilled on trust lands. It is estimated that 1,566 future wells can be expected in approved spacing units within the reservation. Of those, approximately 90% will be on trust lands.

	Trust (50% for tribe)	*Non-Trust (20% for tribe)*
Post-Agreement Wells Today	86	388
Future Wells Projected	1409	157
Total Wells expected within Fort Berthold	1495 (73%)	545 (27%)

Based on this projected distribution of wells between trust and non-trust lands, and because the strong majority of wells are expected to be on trust lands, we can expect that for every $1M in oil and gas tax revenue, approximately $420,000 would go to the tribe and $580,000 would go to the state.

Tribal oil and gas tax revenues have grown steadily since the agreement was signed. The distribution of production and extraction tax revenue to the tribe recently has reached $7 million per month. Total revenues distributed to the tribe so far are in excess of $115 million. It should be noted that this total does not include the tribe's Tribal Employment Rights Office ("TERO") and Tribal Application fees that total $100,000 per well for wells in spacing units that have a majority of trust lands. The total also does not include substantial mineral royalty revenue flowing to the tribe as a mineral owner. One cannot project these numbers into the future with certainty due to volatile oil prices and other factors, but the trends to date have been very positive and show the agreement's great success in creating the kind of environment that results in strong economic growth. The growing activity has created strong revenue for the tribe to fund its current needs and provide for the future of its members. Beyond the benefit of the tax revenue to the tribal government, tribal members living on the reservation have benefited as well. Unemployment on the reservation has fallen from around 40 percent prior to the boom to around 7 percent, according to statements by TAT Chairman Tex Hall.

Tribal Request to Renegotiate the Agreement.

The Tribe has expressed its view that the current division of tax revenues between the state and tribe is unfair. In a Three Affiliated Tribes Resolution No. 11-116-VJB, adopted November 28, 2011, the tribe requested a division of 80 percent for the tribe on trust land and continuing the 20 percent for the tribe on non-trust land. The current division of production and extraction taxes of 20 percent on non-trust lands and 50 percent on trust lands is required by statute and not subject to renegotiation by the state absent a change in law. As a result, the Governor's response to the Tribe's request to renegotiate the revenue division in agreement was simply that it could not be amended unless the law was first amended.

Whether the current division or any proposed new division is fair is not a determination that can be made objectively. In considering whether a change in the division should be made, one ought to consider that the vast majority of future development expected on the reservation will be on trust lands, which are subject to a 50-50 revenue split under the current agreement. Because much of the early development occurred on non-trust lands, the state has received a greater share of the tax revenue than the tribe. As future development trends shift to most new wells coming on trust land, the division will move closer to fifty-fifty.

The tribe's concerns as expressed in its November 2011 resolution emphasize the significant impacts on reservation roads and infrastructure as well as increased costs to provide emergency response, law enforcement, and other services required as a result of the rapid oil and gas development. The state has made significant investments in repairs and improvements to Highway 22 and Highway 23 to better serve transportation needs in and around the reservation. The State's Energy Infrastructure and Impact Office has awarded more than $7 million in grants to the reservation communities of New Town and Parshall for emergency services, law enforcement, and infrastructure projects. Any consideration of what is a fair distribution should include consideration of the state's investments in physical infrastructure, grants for local law enforcement and emergency services, as well as the state's operational costs for the regulatory infrastructure that oversees the industry. If the legislature reaches the conclusion that the parameters of the oil and gas tax agreement ought to be re-examined, the Governor is always willing to sit down with the tribe and discuss the issues to ensure the agreement is fair to both the state and the tribe.

The oil and gas tax agreement we have has worked well and the revenue projected to be generated for both the state and the tribe are continues to increase. By creating a more predictable tax environment within the reservation, the oil and gas tax agreement has removed significant barriers to oil and gas development and helped to spread the activity and prosperity found across the rest of the Bakken into the Fort Berthold Reservation. The tribal government has been a good partner in implementing the agreement and the state looks forward to a continued positive working relationship.