MICROFILM DIVIDER

OMB/RECORDS MANAGEMENT DIVISION
SFN 2053 (2/85) 5M

ROLL NUMBER

DESCRIPTION

1341

2003 HOUSE NATURAL RESOURCES

HB 1341

2003 HOUSE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. 1341

House Natural Resources Committee

❑ Conference Committee

Hearing Date February 6, 2003

Tape Number	Side A	Side B	Meter #
3	xx		3120-5089
3		xx	469-640
Committee Clerk Signature Eric Mertz			

Minutes:

Chair Nelson called the meeting on HB 1341 relating to royalty exemptions for oil and gas produced on public lands to order.

Rep. Skarphol: This bill is here to fix the under exploration of land in North Dakota. This bill is designed to mimic Saskatchewan policy on exploration. I do not predict a massive use of this policy. This will help create some interest in new areas for exploration. This request has to come in before the well is drilled.

Rep. Solberg: The double royalty would be in effect for the life of the well.

Rep. Skarphol: The company has recovered the drilling and casing costs. Then it would be in effect for the life of the well.

Chair Nelson: Do you anticipate how much activity will occur from this bill.

Rep. Skarphol: Two of the three companies I spoke to were not interested.

Rep. Keiser: Rather than a double royalty it could be paid off over time?

Rep. Skarphol: This was patterned after Saskatchewan. This is what they do.

Dennis Daniel: Testified in opposition to 1341. You should be careful what you give away.

Ron Ness: ND Petroleum Council. Testified in opposition to HB 1341. This bill has good intentions, however there are many bills that do a better job of addressing this issue.

Rick Larson (4489): ND State Land Department. Testified against HB 1341. **(See Attached Testimony).**

Chair Nelson closes the hearing.

Committe Work:

Chair Nelson called the meeting to order.

Rep. Clark Moved a Do Not Pass on HB 1341 seconded by **Rep. Solberg**.

The motion carried by a vote of 14-0-0. **Rep. Norland** carried.

FISCAL NOTE

Requested by Legislative Council
01/15/2003

Bill/Resolution No.: HB 1341

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

	2001-2003 Biennium		2003-2005 Biennium		2005-2007 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues			($188,005)	($282,007)	($99,578)	($149,368)
Expenditures				$21,938		$22,596
Appropriations				$21,938		$22,596

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

2001-2003 Biennium			2003-2005 Biennium			2005-2007 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts

2. **Narrative:** *Identify the aspects of the measure which cause fiscal impact and include any comments relevant to your analysis.*

The aspect of the HB1341 that allows a royalty "holiday" causes revenues to be either deferred or permanently reduced.

3. **State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*
   A. **Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

General fund revenue will be reduced due to decreased oil and gas royalty collections in the Lands and Minerals fund. Special fund revenue will be reduced due to decreased oil and gas royalty collections in the permanent educational trusts managed by the Board of University and School Lands.

   B. **Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

The increased expenditures result from the need for audits of the drilling costs.

   C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, of the effect on the biennial appropriation for each agency and fund affected and any amounts included in the executive budget. Indicate the relationship between the amounts shown for expenditures and appropriations.*

The increase in appropriation reflects audit activity that would take place assuming 12 oil wells per biennium fell under the provisions of HB 1341. A .25 FTE position would be needed to conduct operator drilling cost audits.

Name:	Keith W. Bayley	**Agency:**	Land Department
Phone Number:	328-1912	**Date Prepared:**	01/22/2003

Date: 2/6/03
Roll Call Vote #: 1

2003 HOUSE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 1341

House House Natural Resources Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken Do Not Pass

Motion Made By Clark Seconded By Solberg

Representatives	Yes	No	Representatives	Yes	No
Chairman Jon O. Nelson	✓				
Vice-Chairman Todd Porter	✓				
Rep. Byron Clark	✓				
Rep. Duane DeKrey	✓				
Rep. David Drovdal	✓				
Rep. Lyle Hanson	✓				
Rep. Bob Hunskor	✓				
Rep. Dennis Johnson	✓				
Rep. George Keiser	✓				
Rep. Scott Kelsh	✓				
Rep. Frank Klein	✓				
Rep. Mike Norland	✓				
Rep. Darrell Nottestad	✓				
Rep. Dorvan Solberg	✓				

Total (Yes) 14 No 0

Absent 0

Floor Assignment Norland

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

Module No: HR-23-1928
Carrier: Norland
Insert LC: . Title: .

REPORT OF STANDING COMMITTEE

HB 1341: Natural Resources Committee (Rep. Nelson, Chairman) recommends **DO NOT PASS** (14 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). HB 1341 was placed on the Eleventh order on the calendar.

2003 TESTIMONY

HB 1341

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ND STATE LAND DEPARTMENT
Helping to Fund Education
Gary D. Preszler, Commissioner

TESTIMONY OF RICK D. LARSON
Director of Minerals Management
North Dakota State Land Department

IN OPPOSITION TO
HOUSE BILL NO. 1341

House Natural Resources Committee
February 6, 2003

The Board of University and School Lands, through the office of the Commissioner of University and School Lands, also known as the State Land Department, manages property given to the state of North Dakota by the federal government when we became a state and manages minerals acquired by the State through the years. The property is held in 14 trusts to be used exclusively for various schools and institutions, including the common schools trust (public grades K-12) and minerals acquired by the State in the Land and Minerals Trust Fund. The mineral interests in all of these trusts are leased through a public bidding process for mineral development, including drilling of oil and gas wells. Those assets are managed as a prudent investor would manage assets.

It is our opinion that the degree of uncertainty and speculation in the application of this bill would not be appropriate for the Board of University and School Lands, acting in their fiduciary capacity as trustees. House Bill 1341 provides that the Board of University and School Lands can enter into an agreement with an oil company and provides that the company could drill an oil well and the Board would not receive any royalty until the company recovered its cost of drilling the well. Thereafter the Board would receive a royalty of twice as much as is in the lease agreement. This type of arrangement is extremely risky.

In North Dakota oil is found in only one of seven wildcat wells. This statistic only shows the risk of drilling wells; not the capacity of a well to generate sufficient revenue to pay for the cost of drilling the well. The following chart helps to illustrate why we think it is imprudent to enter into such an arrangement. We have used the following information and assumptions preparing this chart:

- In the last six years, 42 wells were completed on state-owned minerals. We took the first twelve of these wells to determine, in hindsight, if it would have been profitable for the Board to have speculated and entered into an agreement provided for in the bill.
- Drilling and completion costs are calculated at $74.07 per foot. This is an old published figure from the Independent Petroleum Association of America and is the average cost of drilling and completing a well in North Dakota. We have used this average because we do not know actual drilling costs for these wells. In discussions with Lynn Helms, Director of the Oil and Gas Division of the Industrial Commission, this figure is probably low and could be closer to $85.00 per foot.
- We used 4.5% to calculate the time value of money.
- We used actual values for these wells to date and used a constant figure of $20.59 per barrel of oil for future production. This is the average price per barrel we received for the year 2002.

- We used the actual reported volumes for the wells to date. We then set the production volume of the well to a fixed number of barrels to project future production for each well. We could have tried to show a continual decline.

Summary of Payout and Recovery of Analyzed Wells

Well Cost @$74.07/ft	Months to Payout	Months to Recover
$970,094	117	never
$808,770	65	never
$766,624	71	never
$685,147	160	never
$982,316	47	177
$722,923	13	118
$455,309	21	108
$777,883	28	81
$884,395	20	65
$852,990	19	46
$1,060,682	18	42
$599,967	8	21

In four of the 12 wells we would for sure never recover the revenue which we would be deferring. Another three would take from nine to over fourteen years. That is, if the well is not prematurely plugged because of the added royalty burden. Only one out of the twelve would recover the drilling cost within a 24 month period. The four remaining wells would take between 42 months to almost 7 years to recover costs. Those five "good" wells would not recapture enough revenue to offset the lost royalties of the seven wells.

If a request from a company is received by the Board, it cannot simply say "yes" or "no". The proposal would require added research before a decision can be made. That research would probably require at a minimum a geologist and petroleum engineer to help in the decision. The company making the request would have much more information at its disposal to help in their analysis. They would have a geophysicist and a reservoir engineer to analyze their seismic programs and reservoir data before they decide to drill a well. It is doubtful that a company would share that information with us to help us decide if we are going to agree to participate in the well. And if it looked favorable, why would they be approaching the Board at all? In other words, the more risky wells would be the wells that we would be given the opportunity to join.

What are drilling costs? There are many costs that go into drilling a well. The bill language refers to "reasonable cost of drilling, excluding any charge for supervision". This language appears to come from the Oil and Gas Division statutes. "Reasonable cost of drilling" is not defined. It is unclear what cost of drilling would entail. It may include preparing the site for drilling. It may include constructing the drilling rig at the drill site. It may start at the time a drilling rig begins to turn the drilling bit into the ground. Does drilling cost also include the cost of completion?

Whatever those costs are will vary substantially from company to company and well by well. That variability can be illustrated by information received in a survey done by the North Dakota Geological Survey. Completion costs for two wells drilled to 9,800 feet were $600,164 for one company and $1,310,000 for the other, or a range of $61 per foot to $133 per foot. Further, if the well being drilled experiences unforeseen problems that drilling cost would increase substantially. The Board would be participating in that unknown cost by foregoing any royalty until those costs are recovered.

Additional expenses caused by the Bill is the cost of auditing both the drilling costs and the royalty collections. The bill appears to try to move that responsibility away from the Board of University and School Lands to the Industrial Commission. The State Land Department would be auditing any cost that a company would ultimately wish to charge against the drilling costs of a particular well. This Bill would require additional help to audit all the drilling costs. The bill specifies that the Industrial Commission would finally determine the drilling costs if there is a dispute of these costs. The Oil and Gas Division of the Industrial Commission does not currently have personnel or experience in determining those costs and the value of oil and gas. Royalty valuation is something that State Land Department personnel would do in the normal course of its responsibilities and would not agree to delegate to another agency.

The operator's interest is different than our interest. How long the operator of an oil well is going to produce a well is limited by the revenue and expenses of a given well. If the well proceeds do not cover expenses the well will be plugged and abandoned. The well has reached its economic limit. By doubling the royalty rate the economic limit will be reached much sooner. The company has covered its drilling costs early in the life of the well. At the end of the life of a well the costs are labor, equipment, royalty, and taxes. The operator is not worried about being sure we get back our deferred royalty. If the additional royalty increases the expenses beyond the current revenues, the well is plugged. Thus oil is left in the ground causing waste of the resource.

In summary, we oppose the bill because:

- The risk of never recovering revenues is greater than the reward potential. We would be gambling that the revenues would be recovered.

- We would have the administrative burden of reviewing company requests. We would be spending money to hire an expert to review a company's proposal. This review itself would be speculative, because no one knows what will be recovered from a particular well until it is drilled.

- We would have to audit a company's records to be assured that drilling costs were correctly allocated to a particular well. Again, these costs will vary from company to company and well by well.

- The General Fund revenue reductions could be caused by a reduction in the production to the Land and Minerals Trust Fund and the Special Funds revenue reductions would primarily be a reduction in the Common Schools Trust.

We respectfully request a "do not pass" recommendation for HB 1341.