

**2021 HOUSE FINANCE AND TAXATION**

**HB 1080**

# 2021 HOUSE STANDING COMMITTEE MINUTES

## Finance and Taxation Committee Room JW327E, State Capitol

HB 1080  
1/6/2021

A bill relating to the obligation to pay oil and gas royalties on leases owned and managed by the board of university and school lands.

**Chairman Headland** opened the hearing on HB 1080 at 1:00pm. Roll call for attendance was taken:

<b>Representatives</b>	<b>Present</b>
Representative Craig Headland	Y
Representative Vicky Steiner	Y
Representative Dick Anderson	Y
Representative Glenn Bosch	Y
Representative Jason Dockter	Y
Representative Sebastian Ertelt	Y
Representative Jay Fisher	Y
Representative Patrick Hatlestad	Y
Representative Zachary Ista	Y
Representative Tom Kading	Y
Representative Ben Koppelman	Y
Representative Marvin E. Nelson	Y
Representative Nathan Toman	Y
Representative Wayne A. Trottier	Y

### Discussion Topics:

- Oil and gas royalties
- Penalties for late or unpaid royalties

**Representative Dockter** introduced the bill at 1:00pm.

**Ron Ness, President of the North Dakota Petroleum Council.** Written testimony provided online (#98). Ended verbal testimony at 1:07pm.

No further testimony in support.

No testimony in opposition.

**Jodi Smith, Commissioner and Secretary for the Board of University and School Lands** read her submitted testimony in a neutral capacity (testimony #70). Ended verbal testimony at 1:17pm.

No further testimony.

House Finance and Taxation Committee  
HB 1080  
January 6, 2021  
Page 2

**Chairman Headland** closed the hearing at 1:29pm.

*Mary Brucker, Committee Clerk*



**House Bill 1080**  
**Testimony of Ron Ness**  
**House Finance and Taxation Committee**  
**January 6, 2021**

Chairman Headland and members of the Finance and Taxation Committee, my name is Ron Ness, president of the North Dakota Petroleum Council. The North Dakota Petroleum Council represents more than 650 companies in all aspects of the oil and gas industry, including oil and gas production, refining, pipeline, transportation, mineral leasing, consulting, legal work, and oilfield service activities in North Dakota. I appear before you today in support of House Bill 1080.

House Bill 1080 creates a separate subsection to Section 15-05-10 of the North Dakota Century Code relating to royalties from oil and gas leases owned and managed by the North Dakota Board of University and School Lands (“Land Board”). Specifically, the bill relocates the obligation to pay royalties on minerals produced from such leases to the Land Board’s section of the Century Code. House Bill 1080 also adjusts the consequences for a breach of the obligation to pay royalties to a more equitable and fair rate. Currently, state law combines the obligation and consequences for breach for both Land Board-managed leases and leases held privately, with maximum interest on unpaid royalties set at a rate of eighteen percent. Through the North Dakota Administrative Code, the Land Board also has the authority to assess an additional penalty of up to twelve percent on unpaid royalties from state leases. This allows the Land Board to assess and collect combined interest and penalties on unpaid royalties at a rate of up to 30%. This is unreasonable and must be changed. Even U.S. Internal Revenue Service regulations do not go this far.

The statute allowing eighteen percent interest on unpaid royalties owed on private leases was enacted in 1981 when the prime interest rates were hovering in the fourteen to eighteen percent range. N.D.C.C. 47-16-39.1 was enacted and pertained specifically to “Obligation to Pay Royalties” with specific intent to benefit North Dakota mineral owners. A separate provision was later added applying specifically to Land

Board owned and managed leases, allowing the Board to negotiate an interest rate less than eighteen percent but no less than the prime rate plus four percent up to a maximum of eighteen percent. Unlike private mineral owners, the Land Board has its own auditors, attorneys, and tools to track and collect royalties it deems due. Therefore, House Bill 1080 proposes to remove the language in Section 47-16-39.1 pertaining to the Land Board, relocates the obligation to pay royalties to the State to a more appropriate section, and adjusts the combined maximum interest and penalty rates for breach of state royalty payment requirements to one that is equitable and consistent with what is fair and reasonable.

A combined 30% interest and penalty rate for late or unpaid royalties is unnecessarily punitive and inhibits a healthy business relationship between the State and those producing its mineral resources. In a short time, combined penalty and interest amounts owed for underpaid or unpaid royalties can far exceed any principal amount that may originally be owed, and there is nothing to prevent accrual of those amounts. This has been a contentious issue as oil operators continue to legally dispute the gas royalty deduct determination and the Land Board continues to seek payment for those disputed royalties retroactive to as many as forty years. As a comparison, all other businesses are subject to a statute of limitation of six years for contractual breaches with a maximum interest rate of six percent. Additionally, a private mineral owner cannot assess a penalty in addition to the eighteen percent interest rate prescribed by law. Once again, not even the IRS can go back 40 years on unpaid amounts. Such an unlimited statute of limitations is well beyond any reasonable record retention rules and is simply irrational.

The North Dakota Petroleum Council, on behalf of its members, requests fairness and consistency in the laws affecting the oil and gas industry and a reasonable yet effective combined penalty and interest rate for the Land Board to use to for royalty collections when no other solution exists. House Bill 1080 modernizes the language by using prime plus four percent instead of including a punitive rate in the statute from the early 1980's when interest rates were three to five times the prime rate of today.

We therefore urge a **Do Pass** on House Bill 1080. I would be happy to answer any questions.



**TESTIMONY OF JODI SMITH  
COMMISSIONER  
North Dakota Department of Trust Lands**

**House Bill 1080**

**House Finance and Taxation Committee  
January 6, 2021**

Chairman Headland and members of the House Finance and Taxation Committee, I am Jodi Smith, the Commissioner and Secretary for the Board of University and School Lands (Board). I am here to testify on House Bill 1080.

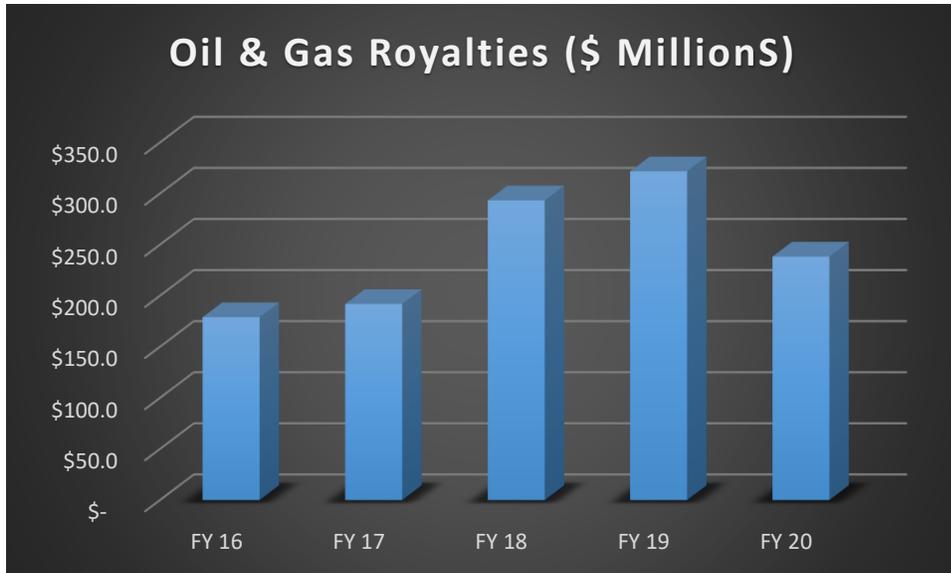
The Department of Trust Lands (Department) is the administrative arm of the Board, serving under the direction and authority of the Board. The Board is comprised of the Governor, Secretary of State, Attorney General, State Treasurer, and Superintendent of Public Instruction. The Department's primary responsibility is managing the Common Schools Trust Fund (CSTF) and 12 other permanent educational trust funds. The beneficiaries of the trust funds include local school districts, various colleges and universities, and other institutions in North Dakota. The Department manages five additional funds: the Strategic Investment and Improvements Fund, the Coal Development Trust Fund, the Capitol Building Fund, the Indian Cultural Education Trust, and the Theodore Roosevelt Presidential Library and Museum Endowment.

The Department also administers the responsibilities outlined in the Uniform Unclaimed Property Act, N.D.C.C. ch. 47-30.1. In this role the Department collects "unclaimed property" (uncashed checks, unused bank accounts, etc.), and processes owners' claims. This property is held in permanent trust for owners to claim, with the revenue from the investment of the property benefiting the CSTF.

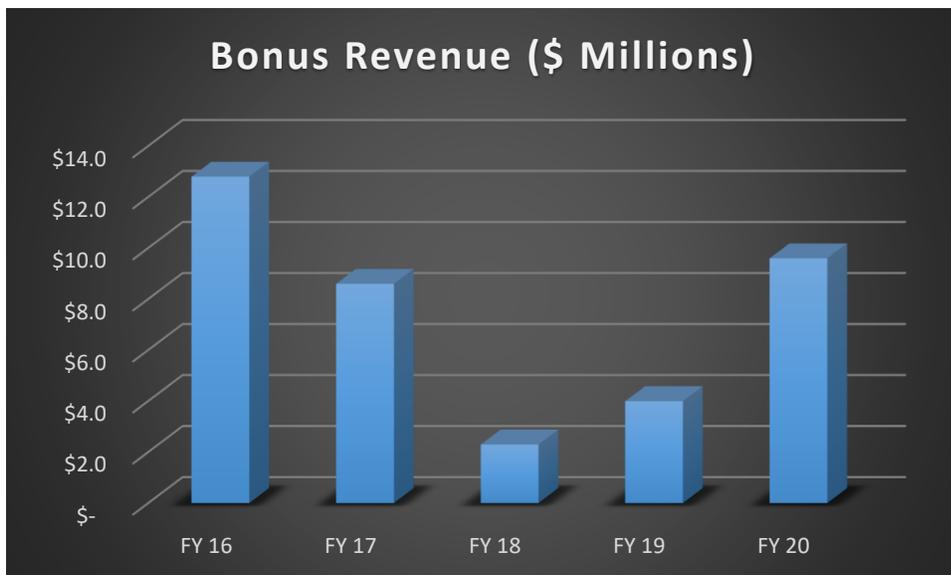
Additionally, the Department operates the Energy Infrastructure and Impact Office (EIIO), which provides financial support to political subdivisions that are affected by energy development. Assistance is provided through both the oil and gas impact grant program and the coal impact loan program.

The Department's Revenue Compliance Division is responsible for developing and implementing procedures to assure the timely and accurate accounting of all royalties, bonuses, rentals, and other revenues received. A significant amount of time is dedicated to evaluating the accounting and collection of oil and gas royalties.

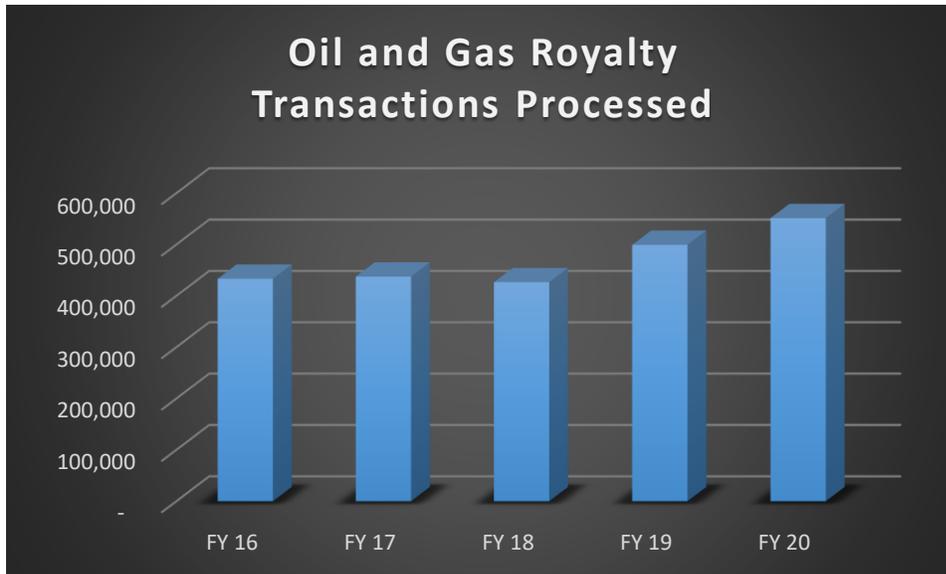
The Department recognized oil and gas royalty revenues of approximately \$321.9 million in Fiscal Year (FY) 2019 and \$238.4 million in FY 2020.



Bonus revenue received totaled \$4.0 million in FY 2019 and \$9.6 million in FY 2020.



Royalty transactions include prior period adjustments and current period payments. Often, multiple transactions will occur on the same statement for the same property due to multiple tracts in the same spacing unit, reporting of various products, and prior period adjustments.



Royalty data is reviewed for discrepancies in volume, ownership, valuation, and lease terms. Reported volume data is compared with the North Dakota Industrial Commission's data to identify variances. Additionally, division orders and submitted royalty reports are reviewed to identify potential issues. These efforts have brought additional revenue to the trusts that may not have otherwise been collected. The table below details the results of these efforts.

<b>Collections</b>				
	<b>FY 17</b>	<b>FY 18</b>	<b>FY 19</b>	<b>FY 20</b>
Additional Royalties Collected	\$295,678	\$81,436	\$460,829	\$427,517
Repaid Taxes and Deductions Taken in Error	42,580	797,882	0	710,011
Penalties & Interest Collected	306,473	293,365	564,617	636,898
<b>Total Collections</b>	<b>\$644,731</b>	<b>\$1,172,683</b>	<b>\$1,025,447</b>	<b>\$1,774,426</b>

HB 1080 is a bill to amend and reenact N.D.C.C. Sections 15-05-10 and 47-16-39.1 amending language to reduce the maximum rate owed by royalty payors to the Board for late oil and gas royalty payments. The Department will seek direction from the Board on how to proceed with respect to this bill and respectfully requests the opportunity to provide additional information if directed by the Board.

# 2021 HOUSE STANDING COMMITTEE MINUTES

## Finance and Taxation Committee Room JW327E, State Capitol

HB 1080  
1/20/2021

A bill relating to the obligation to pay oil and gas royalties on leases owned and managed by the board of university and school lands.

**Chairman Headland** opened discussion at 10:16am.

<b>Representatives</b>	<b>Present</b>
Representative Craig Headland	P
Representative Vicky Steiner	P
Representative Dick Anderson	P
Representative Glenn Bosch	P
Representative Jason Dockter	P
Representative Sebastian Ertelt	P
Representative Jay Fisher	P
Representative Patrick Hatlestad	P
Representative Zachary Ista	P
Representative Tom Kading	P
Representative Ben Koppelman	P
Representative Marvin E. Nelson	P
Representative Nathan Toman	P
Representative Wayne A. Trottier	P

### **Discussion Topics:**

\*Obligation to pay oil and gas royalties on leases owned by board of university and school lands

Committee discussion.

Meeting adjourned at 10:16am.

*Mary Brucker, Committee Clerk*

# 2021 HOUSE STANDING COMMITTEE MINUTES

## Finance and Taxation Committee Room JW327E, State Capitol

HB 1080  
2/3/2021

A bill relating to the obligation to pay oil and gas royalties on leases owned and managed by the board of university and school lands.
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**Chairman Headland** opened up for discussion at 3:06pm.

<b>Representatives</b>	<b>Present</b>
Representative Craig Headland	Y
Representative Vicky Steiner	Y
Representative Dick Anderson	Y
Representative Glenn Bosch	Y
Representative Jason Dockter	Y
Representative Sebastian Ertelt	Y
Representative Jay Fisher	Y
Representative Patrick Hatlestad	Y
Representative Zachary Ista	Y
Representative Tom Kading	Y
Representative Ben Koppelman	Y
Representative Marvin E. Nelson	Y
Representative Nathan Toman	Y
Representative Wayne A. Trottier	Y

### Discussion Topics:

- Proposed amendments
- Royalty payments

**Representative Dockter** explained amendment 21.0369.01001 (#5269).

**Jodi Smith, Commissioner for University and School Lands**, answered questions from the committee.

**Brady Pelton, Government Affairs Manager for the North Dakota Petroleum Council**, answered questions from the committee.

**Jodi Smith** continued to answer questions from the committee.

**Representative B. Koppelman** made a motion to adopt amendment 21.0369.01001.

**Representative D. Anderson** seconded the motion.

**Voice vote-motion carried.**

**Representative B. Koppelman made a motion for a Do Pass As Amended.**

**Representative D. Anderson seconded the motion.**

**Roll call vote:**

<b>Representatives</b>	<b>Vote</b>
Representative Craig Headland	Y
Representative Vicky Steiner	N
Representative Dick Anderson	Y
Representative Glenn Bosch	Y
Representative Jason Dockter	Y
Representative Sebastian Ertelt	N
Representative Jay Fisher	N
Representative Patrick Hatlestad	Y
Representative Zachary Ista	N
Representative Tom Kading	Y
Representative Ben Koppelman	Y
Representative Marvin E. Nelson	N
Representative Nathan Toman	Y
Representative Wayne A. Trottier	Y

**Motion carried 9-5-0**

**Representative B. Koppelman will be the bill carrier.**

**Chairman Headland** closed the hearing at 3:36pm.

*Mary Brucker, Committee Clerk*

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1080

Page 1, line 20, remove "or the board's assignee"

Page 1, line 21, remove "or the board's assignee"

Page 2, line 1, replace "operator" with "lessee or the lessee's representative or assignee"

Page 2, line 1, remove "or the"

Page 2, line 2, remove "board's assignee"

Page 2, line 2, remove "one hundred fifty days after oil or gas produced under the"

Page 2, line 3, replace "lease is marketed" with "the time prescribed by administrative rule"

Page 2, line 3, replace "operator" with "lessee or the lessee's representative or assignee"

Page 2, line 4, remove "and penalties"

Page 2, line 4, remove "to be no greater than"

Page 2, remove lines 5 through 11

Page 2, line 12, replace "attorney's fees" with "of three quarters of one percent per month, not to exceed nine percent per annum. The commissioner may waive all or a portion of the interest under this subsection for good cause"

Page 2, line 13, after "3." insert "If a lessee or the lessee's representative or assignee fails to respond or refuses to file an amended royalty statement and pay the royalty owed within ninety days of receiving written notice by mail of an underpayment, as provided by rule 4 of the North Dakota Rules of Civil Procedure, the board may impose a penalty of one-half percent per month, not to exceed six percent per annum. A party is deemed to have failed to respond if the party has not responded within ninety days of receipt of the written notice, or the party in response to the notice affirmatively indicates the intent not to pay the royalty or amounts due. The commissioner may waive all or a portion of the interest under this subsection for good cause.

4. If a lessee or the lessee's representative or assignee disputes a royalty assessment or demand by the board, the lessee or the lessee's representative or assignee may tender full payment of the disputed amount under protest any time after an assessment or demand is made by the board. Upon payment of the disputed amount under protest, all interest and penalties must cease to accrue. If it is determined that the payment of the disputed amount resulted in an overpayment, the party that made the payment is entitled to a refund of the overpayment amount plus interest at the rate established under section 28-20-34.
5. If a lessee or the lessee's representative or assignee fails or refuses to comply with demands by the board to pay royalties, interest, or penalties under this chapter, the board may file suit to cancel the lease, recover unpaid royalties, and recover interest and penalties on the unpaid royalties. A lawsuit under this subsection must be commenced within six years of the last day of the calendar month after the month in which the oil

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2 of 2

or gas was produced under the lease for which the subject royalties are owed. This subsection applies to royalties due on or after August 1, 2015.

6."

Renumber accordingly

**REPORT OF STANDING COMMITTEE**

**HB 1080: Finance and Taxation Committee (Rep. Headland, Chairman)** recommends **AMENDMENTS AS FOLLOWS** and when so amended, recommends **DO PASS** (9 YEAS, 5 NAYS, 0 ABSENT AND NOT VOTING). HB 1080 was placed on the Sixth order on the calendar.

Page 1, line 20, remove "or the board's assignee"

Page 1, line 21, remove "or the board's assignee"

Page 2, line 1, replace "operator" with "lessee or the lessee's representative or assignee"

Page 2, line 1, remove "or the"

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5. If a lessee or the lessee's representative or assignee fails or refuses to comply with demands by the board to pay royalties, interest, or penalties under this chapter, the board may file suit to cancel the lease, recover unpaid royalties, and recover interest and penalties on the unpaid royalties. A lawsuit under this subsection must be commenced within six years of the last day of the calendar month after the month in which the oil or gas was produced under the lease for which the subject royalties

are owed. This subsection applies to royalties due on or after August 1, 2015.

6."

Renumber accordingly

21.0369.01001  
Title.

Prepared by the Legislative Council staff for  
Representative Dockter  
February 3, 2021

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1080

Page 1, line 20, remove "or the board's assignee"

Page 1, line 21, remove "or the board's assignee"

Page 2, line 1, replace "operator" with "lessee or the lessee's representative or assignee"

Page 2, line 1, remove "or the"

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5. If a lessee or the lessee's representative or assignee fails or refuses to comply with demands by the board to pay royalties, interest, or penalties under this chapter, the board may file suit to cancel the lease, recover unpaid royalties, and recover interest and penalties on the unpaid royalties. A lawsuit under this subsection must be commenced within six years of the last day of the calendar month after the month in which the oil

or gas was produced under the lease for which the subject royalties are owed. This subsection applies to royalties due on or after August 1, 2015.

6."

Renumber accordingly

# 2021 HOUSE STANDING COMMITTEE MINUTES

Finance and Taxation Committee  
Room JW327E, State Capitol

HB 1080  
2/8/2021

A bill relating to the obligation to pay oil and gas royalties on leases owned and managed by the board of university and school lands.
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**Chairman Headland** opened up for discussion at 2:58pm.

<b>Representatives</b>	<b>Present</b>
Representative Craig Headland	Y
Representative Vicky Steiner	Y
Representative Dick Anderson	Y
Representative Glenn Bosch	Y
Representative Jason Dockter	Y
Representative Sebastian Ertelt	Y
Representative Jay Fisher	Y
Representative Patrick Hatlestad	Y
Representative Zachary Ista	Y
Representative Tom Kading	Y
Representative Ben Koppelman	Y
Representative Marvin E. Nelson	Y
Representative Nathan Toman	Y
Representative Wayne A. Trottier	Y

## **Discussion Topics:**

- Reconsideration of committee actions
- Amendment 21.0369.01002

**Representative Bosch** made a motion to reconsider our actions.

**Representative Fisher** seconded the motion.

**Voice vote-motion carried.**

**Representative Dockter** distributed proposed amendments 21.0369.01002 (#5961) and further amend by taking out the second “be” on the last page of the amendment.

**Representative Dockter** made a motion to adopt the amendments.

**Representative Fisher** seconded the motion.

**Voice vote-motion carried.**

**Representative B. Koppelman made a motion for a Do Pass As Amended.**

**Representative Bosch seconded the motion.**

Roll call vote:

<b>Representatives</b>	<b>Vote</b>
Representative Craig Headland	Y
Representative Vicky Steiner	Y
Representative Dick Anderson	Y
Representative Glenn Bosch	Y
Representative Jason Dockter	Y
Representative Sebastian Ertelt	N
Representative Jay Fisher	Y
Representative Patrick Hatlestad	Y
Representative Zachary Ista	N
Representative Tom Kading	Y
Representative Ben Koppelman	Y
Representative Marvin E. Nelson	N
Representative Nathan Toman	Y
Representative Wayne A. Trottier	Y

**Motion carried 11-3-0**

**Representative B. Koppelman will be the bill carrier.**

**Chairman Headland** closed the discussion at 3:03pm.

*Mary Brucker, Committee Clerk*

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1080

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Page 2, line 1, replace "operator" with "lessee or the lessee's representative or assignee"

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5. If a lessee or the lessee's representative or assignee fails or refuses to comply with demands by the board to pay royalties, interest, or penalties under this chapter, the board may file an action to cancel the lease, recover unpaid royalties, and recover interest and penalties on the unpaid royalties. Notwithstanding chapter 28-01, an action under this subsection must be commenced within six years of the date oil or gas was produced

under a lease. An action to cancel a lease, recover unpaid royalties, or recover interest or penalties on unpaid royalties may not be filed for production that occurred under a lease before August 1, 2015.

97  
2/1/21

6."

Renumber accordingly

**REPORT OF STANDING COMMITTEE**

**HB 1080: Finance and Taxation Committee (Rep. Headland, Chairman)** recommends **AMENDMENTS AS FOLLOWS** and when so amended, recommends **DO PASS** (11 YEAS, 3 NAYS, 0 ABSENT AND NOT VOTING). HB 1080 was placed on the Sixth order on the calendar.

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royalties, or recover interest or penalties on unpaid royalties may not be  
filed for production that occurred under a lease before August 1, 2015.

6."

Renumber accordingly

21.0369.01002  
Title.

Prepared by the Legislative Council staff for  
Representative Dockter  
February 8, 2021

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1080

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- Page 1, line 21, remove "or the board's assignee"
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- Page 2, remove lines 5 through 11
- Page 2, line 12, replace "attorney's fees" with "of three quarters of one percent per month, not to exceed nine percent per annum. The commissioner may waive all or a portion of the interest under this subsection for good cause"
- Page 2, line 13, after "3." insert "If a lessee or the lessee's representative or assignee fails to respond or refuses to file an amended royalty statement and pay the royalty owed within ninety days of receiving written notice by mail of an underpayment, as provided by rule 4 of the North Dakota Rules of Civil Procedure, the board may impose a penalty of one-half percent per month, not to exceed six percent per annum. A party is deemed to have failed to respond if the party has not responded within ninety days of receipt of the written notice, or the party in response to the notice affirmatively indicates the intent not to pay the royalty or amounts due. The commissioner may waive all or a portion of the interest under this subsection for good cause."
  - 4. If a lessee or the lessee's representative or assignee disputes a royalty assessment or demand by the board, the lessee or the lessee's representative or assignee may tender full payment of the disputed amount under protest any time after an assessment or demand is made by the board. Upon payment of the disputed amount under protest, all interest and penalties must cease to accrue. If it is determined that the payment of the disputed amount resulted in an overpayment, the party that made the payment is entitled to a refund of the overpayment amount plus interest at the rate established under section 28-20-34.
  - 5. If a lessee or the lessee's representative or assignee fails or refuses to comply with demands by the board to pay royalties, interest, or penalties under this chapter, the board may file an action to cancel the lease, recover unpaid royalties, and recover interest and penalties on the unpaid royalties. Notwithstanding chapter 28-01, an action under this subsection must be commenced within six years of the date oil or gas was produced

under a lease. An action to cancel a lease, recover unpaid royalties, or recover interest or penalties on unpaid royalties may not be filed for production that occurred under a lease before August 1, 2015.

6."

Renumber accordingly

**2021 SENATE ENERGY AND NATURAL RESOURCES**

**HB 1080**

# 2021 SENATE STANDING COMMITTEE MINUTES

## Energy and Natural Resources Committee Peace Garden Room, State Capitol

HB 1080  
3/12/2021

Relating to the obligation to pay oil and gas royalties on leases owned and managed by the board of university and school lands.
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Hearing called to order, all senators are present: **Bell, Schaible Piepkorn, Roers, Patten, and Kreun.** [10:51]

**Discussion Topics:**

- Uncertainty in the oil industry
- Different royalty interest rates

**Rep. Jason Dockter**, provided testimony in favor [10:51]

**Ron Ness**, ND Petroleum Council provided testimony in favor #8922 [10:52]

**John Kelly**, Continental Resources provided testimony in favor #8881 [11:12]

**Jodi Smith**, ND Land Trusts provided testimony in favor #8963 [11:17]

**Dave Garner**, Assistant Attorney General provided neutral testimony [11:47]

Hearing Adjourned [12:06]

*Sheila Froehlich, Committee Clerk*



**Engrossed House Bill 1080**  
**Testimony of Ron Ness**  
**Senate Energy and Natural Resources Committee**  
**March 12, 2021**

Chairman Kreun and members of the Senate Energy and Natural Resources Committee, my name is Ron Ness, president of the North Dakota Petroleum Council. The North Dakota Petroleum Council (“NDPC”) represents more than 650 companies in all aspects of the oil and gas industry, including oil and gas production, refining, pipeline, transportation, mineral leasing, consulting, legal work, and oilfield service activities in North Dakota. I appear before you today in support of Engrossed House Bill 1080.

House Bill 1080 originated as a bill to create a separate subsection to Section 15-05-10 of the North Dakota Century Code relating to royalties from oil and gas leases owned and managed by the North Dakota Board of University and School Lands (“Land Board”). Specifically, the bill relocates the obligation to pay royalties on minerals produced from such leases to the Land Board’s title of the Century Code. As introduced, House Bill 1080 also adjusts the consequences for a breach of the obligation to pay royalties to a more equitable and fairer rate. Currently, state law combines the obligation and consequences for breach for both Land Board-managed leases and leases held privately, with maximum interest on unpaid royalties set at a rate of eighteen percent that was enacted in 1981 when the prime interest rates were hovering in the fourteen to eighteen percent range. Through the North Dakota Administrative Code, the Land Board also has the authority to assess an additional penalty of up to twelve percent on unpaid royalties from state leases. This allows the Land Board to assess and collect combined interest and penalties on unpaid royalties at a rate of up to 30%. This is unreasonable and must be changed. Even U.S. Internal Revenue Service regulations do not go this far.

As requested by the House Finance and Taxation Committee, representatives of the oil and gas industry met with the North Dakota Department of Trust Lands (“DTL”) to reach a consensus on how state

royalties should be paid. Discussions between the two groups grew to include potential solutions to the issue of disputed state royalties alleged to be owed by the Land Board as a result of the North Dakota Supreme Court decision on Newfield v. State. 2019 ND 193. Newfield was remanded back to the Northwest Judicial District Court for further consideration, with a bench trial date scheduled for October 4, 2021. Despite the lack of resolution of critical case-specific facts in Newfield, which the Land Board is reliant on in alleging millions of dollars in unpaid state royalties, the Board has continued to press those companies alleged to owe state royalties toward settlement. It is this historic backdrop that set the stage for the House Finance and Taxation Committee requesting dialogue between industry and the State to fully address the disputed state royalty issue.

To that end, representatives of the North Dakota Department of Trust Lands and NDPC met numerous times over the course of several weeks to discuss House Bill 1080 and potential solutions. The two groups eventually came to a mutual agreement on the majority of amendments that were ultimately passed by the House of Representatives.

First, in Section 1, subsection 2 of the bill, NDPC and DTL agreed to replace the prime interest plus four percent rate on unpaid royalties with a flat 0.75 percent per month rate, to a maximum of nine percent interest per year. The parties also agreed to provide the ability of the Land Commissioner to waive all or a portion of the interest for good cause. In Section 1, subsection 3 of the bill, NDPC and DTL agreed to allow for penalties on unpaid royalties to be imposed by the Department at a rate of 0.5 percent per month, to a maximum of six percent per year. The penalty provisions allowed in this subsection are tied to formal notice being provided to the lessee via North Dakota Rules of Civil Procedure. Under this language, a lessee would have 90 days following formal notice to pay the royalty owed without being subject to a penalty. Subsection 3 also allows penalties to be waived by the Land Commissioner for good cause.

The parties agreed to provide for payment-under-protest provisions for lessees that wish to dispute a royalty assessment or demand by the Land Board for payment. This provision, included in Section 1,

subsection 4 of the bill, allows a lessee to pay “under protest” and stop interest and penalty assessments against the amount they are alleged to owe. It also allows them to receive a refund of any overpayment, with interest paid to the lessee at the rate of pre-judgment interest set by the North Dakota Supreme Court in N.D.C.C. 28-20-34.

Following several discussions, NDPC and DTL came to a consensus on setting a reasonable statute of limitations on the Land Board’s ability to file suit for lease cancellation, recovery of unpaid royalties, and assessment of interest and/or penalties on unpaid state royalties. This statute of limitations was initially set at ten years, including a ten-year retroactive “lookback” period for any existing alleged unpaid royalties, with the goal of providing a clear, consistent, and reasonable point in time from which the State could collect disputed royalties. The Land Board did not ultimately agree to the statute of limitations and lookback provisions. Nonetheless, the House Finance and Taxation Committee determined that six years was an appropriate amount of time for the Land Board to bring a claim of unpaid state royalties and that looking back six years to August 1, 2015 was reasonable for both the State and industry. Therefore, you have before you today a six-year statute of limitations and lookback period in Section 1, subsection 5 of the bill.

At this time, the only area of contention between the Land Board and industry appears to be in this subsection. Though arguments will likely be made about the potential for violating constitutional anti-gift clause rules by effectively cutting off the State’s ability to pursue disputed royalties alleged to be owed before August 1, 2015, NDPC continues to support the Legislature’s ability to enact a specific statute of limitations period applicable to the Department of Trust Lands and the Land Board. A statute of limitations operates to limit the time a claimant – the Land Board, in this case – can fall back on without taking any action. It is a longstanding judicial and legislative public policy that the purpose of a statute of limitations is to prevent one party from sleeping on their legal rights to the detriment of another party. This is precisely what the Land Board has done.

The dispute between the Board and producers over gas royalties arises out of an oil and gas lease form adopted by the Board in 1979. For several decades, the gas royalty provision was interpreted that the State was owed royalties based on the gross proceeds actually received by the lessee from a third-party gas processor. Decades later, the Board changed its interpretation to provide that deductions imposed by the third-party gas processing company are not deductible against the State's royalty share. It was not until 2017, 38 years after the adoption of the 1979 lease form, that the Board, by letters, formally advised all State lessees and operators they had been taking gas royalty deductions in a way that was out of compliance with their leases. Even now, the Land Board has yet to file a single lawsuit enforcing its claims to disputed state royalties. The only litigation that has been brought so far on this issue has been brought by two oil companies. Those cases have yet to be fully adjudicated.

Subsection 5 of the bill before you today provides a reasonable and fair statute of limitations that protects against unlimited claims. Six years is the statute of limitations for general contract claims between private parties. The six-year window aligns with the statutes of limitations for several other state claims, including claims from the ND Tax Department for delinquent payments and actions by Job Service ND against employers to collect any alleged underpayment of contributions to the state's unemployment insurance fund. Imagine if citizens, employers, and businesses were faced with a 40-year statute of limitations. This is the current situation for oil and gas lessees producing state minerals. There simply is no backstop. Establishing a reasonable statute of limitations furthers the public policy of allowing companies to conduct business with a degree of certainty, free from the disruptive burden of protracted and unknown potential liability and to avoid the difficulty in proof and recordkeeping involving older claims. The North Dakota Legislature has the opportunity now to use its legislative authority to provide this critical protection.

Further, it is highly likely a reasonable lookback limitation period will drive settlements of disputed state royalties, saving both the State and its oil and gas producers immense amounts of time and litigation

expenses. The current value of the state royalties in dispute at this time is effectively zero. Again, the Land Board has not initiated any lawsuit claiming the royalties alleged to be owed.

The North Dakota Petroleum Council, on behalf of its members, requests fairness and consistency in the laws affecting the oil and gas industry and a reasonable yet effective path forward regarding disputed state royalties. House Bill 1080 modernizes the language by creating clear and consistent interest and penalty rates for unpaid state royalties. It also provides fair and reasonable time limits on the State's ability to claim any alleged underpayments. These limits align with those placed on other state agencies and are critical to creating the certainty necessary for continued investment and production in North Dakota.

We therefore urge a **Do Pass** on Engrossed House Bill 1080. I would be happy to answer any questions.

John Kelly  
Director, Internal Audit  
Continental Resources, Inc.

Testimony before the Energy and Natural Resources Committee  
In Support of HB 1080

Friday, March 12, 2021  
10:30 A.M.  
Peace Garden Room  
600 E. Boulevard Ave.  
Bismarck, North Dakota

Mr. Chairman and members of the Committee, for the record, my name is John Kelly and I am the Director, Internal Audit at Continental Resources, Inc. ("Continental") and I am appearing today to speak in support of HB 1080 on behalf of Continental. Thank you for this opportunity to appear and testify at this hearing.

I will be speaking today about the audit process as it relates to the oil and gas industry and the proposed amendments to Section 15-05-10 of the North Dakota Century Code as set forth in HB 1080.

I. Education and Work Experience

As previously mentioned, I am the Director of Internal Audit at Continental and have held this position for [18] years. I have a Bachelor of Science in Accounting from Oklahoma State University. In addition to my accounting degree, I am a Certified Public

Accountant and a Certified Internal Auditor and maintain greater than forty hours of continuing professional education annually. Prior to joining Continental in 2003, I worked at Kerr-McGee and Amerada Hess in audit roles and later as a Controller of several entities including a public utility and midstream marketing company. My duties and responsibilities at Continental include Sarbanes Oxley compliance, operational and financial audits of CLR and contract compliance for joint venture audits and vendor audits. In connection with my professional training and work as an accountant in the oil and gas industry, I became a member of The Council of Petroleum Accountants Society or "COPAS" in 1985 and have been a member of COPAS for most of my career. COPAS is a non-profit professional organization that provides guidance and education on accounting issues in the oil and gas industry. Its mission is to provide expertise for the oil and gas industry through the development of Model Form Accounting Procedures, publications, and education. As a member of COPAS, I have attended both local and national meetings, participated in drafting teams, and opined on documents created by other COPAS members and teams.

## II. The Oil and Gas Auditing Process

Generally speaking, there are two main components to the audit process in the context of oil and gas, the audit of expenditures and the audit of revenues. I will give a brief explanation of each, however, the audit of revenues is more relevant for the purposes of your consideration of HB 1080.

A. Audit of Expenditures

Joint Venture, also known as “JV” is an arrangement/agreement amongst the owners to develop the acreage. The agreement is typically a Joint Operating Agreement (JOA). One company is designated as the Operator and drills, completes and operates the well and performs the accounting. The non-operator(s) who hold interests in that spacing unit have the opportunity; yet, not the obligation to audit those records for propriety. We audit the records of myriad Operators on a two-year basis using a risk-based approach.

The Model Form Joint Operating Agreement (JOA) governs the relationship amongst operators and non-operators of oil and gas interests and provides for certain audit and accounting procedures relating to expenses incurred in connection with the production of oil and gas Per Section 5 of

Subsection D of Article V of the JOA, “Any audit of Operator’s records relating to amounts expended and the appropriateness of such expenditures shall be conducted in accordance with the audit protocol specified in Exhibit “C”.

Exhibit “C” of the JOA sets forth accounting procedures recommended by COPAS and provides that a non-operator “shall have the right to audit the Operator’s accounts and records relating to the Joint Account for any calendar year within the twenty-four (24) month period following the end of such calendar year.”

B. Audit of Revenues

[Audit of revenues, is conducted in a similar manner. As with JV audits, it is critical to the success of the auditor to conduct the audit timely as the records and personnel knowledgeable about those records likely exist if audited within a two year time span. [The audit of Revenue Audits (AG-21, I – FORWARD, A – General Comments), “If the contract is silent regarding the adjustment period, **then applicable state statutes would apply**. However, it is recommended that Revenue Audits should be performed within a reasonable period of time (e. g.,

24-36 months after statements are rendered)” if the contract is silent in regards to the adjustment period.]

HB 1080 amends Section 15-05-10 of the North Dakota Century Code to provide that the Board of University and School Lands (“Board”), as a royalty owner, may institute an action against a lessee for the failure to comply with the Board’s demands to pay royalties, interest, or penalties under Chapter 15-05, but that any such action must be commenced within six (6) years of the date oil or gas was produced under the State lease. In the context of a revenue audit concerning the payment of royalties, the six-year limitation proposed in HB 1080 is reasonable in the oil and gas industry. As discussed above, the JOA imposes a two (2) year deadline on operators to conduct expense audits. Furthermore, the six (6) year statute of limitations proposed in HB 1080 is analogous to the seven (7) year deadline required by the federal government for the auditing of the proper payment of royalties due and owing to the United States under federal oil and gas leases. See 30 U.S.C. § 1724.

In summary, the six (6) year statute of limitations allows for a reasonable period of time for the Board to audit its royalty payments and to make claims related thereto. The oil and gas industry should not be subject to extended look-back periods with respect to revenue audits when the rules governing its own audits are much shorter in length.

Thank you for your time today and I hope my testimony proves to be helpful to the Committee in its consideration of HB 1080.

72373234.1



**TESTIMONY OF JODI SMITH  
COMMISSIONER  
North Dakota Department of Trust Lands**

**House Bill 1080**

**Senate Energy and Natural Resources Committee  
March 12, 2021**

Chairman Kreun and members of the Senate Energy and Natural Resources Committee (Committee), I am Jodi Smith, the Commissioner and Secretary for the Board of University and School Lands (Board). I am here to testify on House Bill 1080.

The Department of Trust Lands (Department) is the administrative arm of the Board, serving under the direction and authority of the Board. The Board is comprised of the Governor, Secretary of State, Attorney General, State Treasurer, and Superintendent of Public Instruction. The Department's primary responsibility is managing the Common Schools Trust Fund (CSTF) and 12 other permanent educational trust funds. The beneficiaries of the trust funds include local school districts, various colleges and universities, and other institutions in North Dakota. The Department manages five additional funds: the Strategic Investment and Improvements Fund, the Coal Development Trust Fund, the Capitol Building Fund, the Indian Cultural Education Trust, and the Theodore Roosevelt Presidential Library and Museum Endowment.

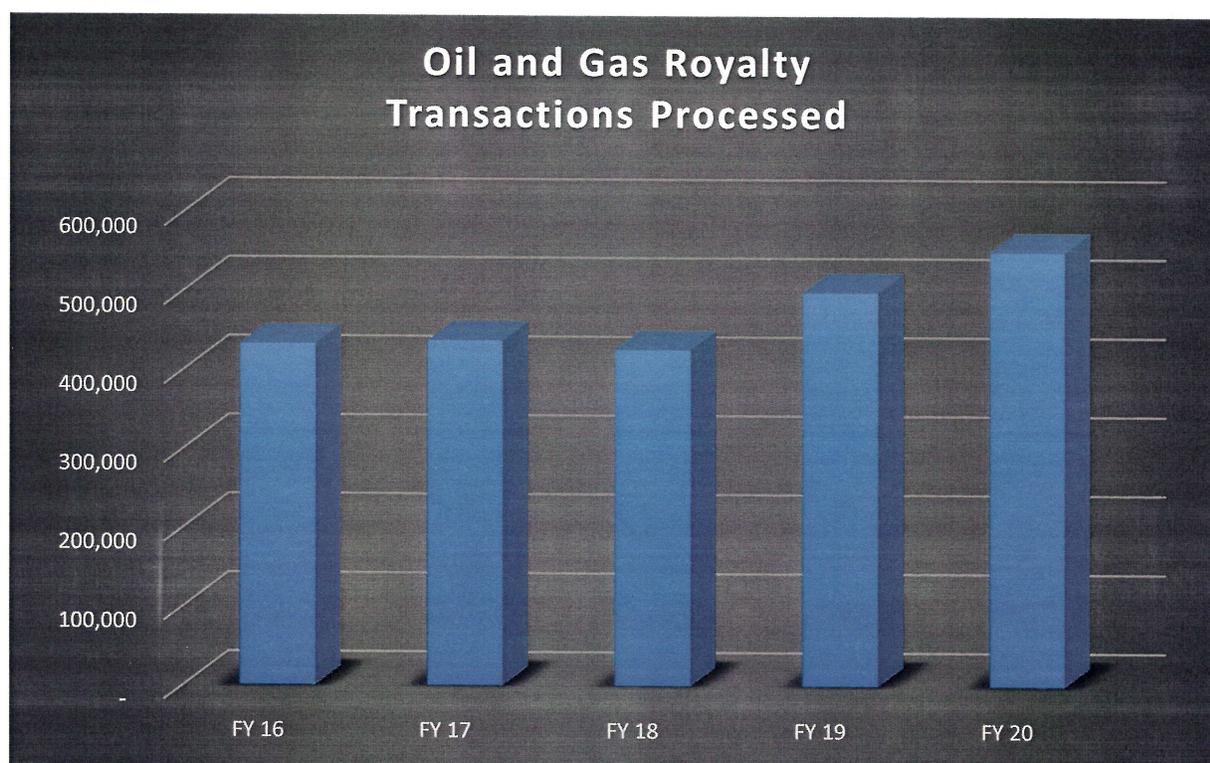
The Department also administers the responsibilities outlined in the Uniform Unclaimed Property Act, N.D.C.C. ch. 47-30.1. In this role the Department collects "unclaimed property" (uncashed checks, unused bank accounts, etc.), and processes owners' claims. This property is held in permanent trust for owners to claim, with the revenue from the investment of the property benefiting the CSTF.

Additionally, the Department operates the Energy Infrastructure and Impact Office (EIIO), which provides financial support to political subdivisions that are affected by energy development. Assistance is provided through both the oil and gas impact grant program and the coal impact loan program.

While the Department has a long standing history of auditing, dating back to 1922, the Board began a concerted effort of auditing oil and gas royalties in the 1980's. Audits performed in the 1980's were primarily related to oil and gas royalties owed under leases issued prior to 1979, which have different terms than leases issued after 1979. These audits resulted in the Board collecting additional royalties dating back to as early as the 1950's. Through the decades, the Board has persistently worked with industry partners to collect payment or establish escrow accounts for royalties from the production of minerals, in accordance with the North Dakota Century Code, the Board's lease, rules, and policies.

Between 2006 and 2011, the Board saw a 240% increase in the number of producing wells, which tripled the number of royalty records that needed to be processed. A formal Revenue Compliance Division was created in March 2011 upon Legislative approval of the hiring of necessary staff. The Department's Revenue Compliance Division (Division) is responsible for developing and implementing procedures to assure the timely and accurate accounting of all royalties, bonuses, rentals, and other revenues received, with a significant amount of time being dedicated to evaluating the accounting and collection of oil and gas royalties.

Royalty transactions include prior period adjustments and current period payments. Often, multiple transactions will occur on the same statement for the same property due to multiple tracts in the same spacing unit, reporting of various products, and prior period adjustments.



Royalty data is reviewed for ownership, valuation, and discrepancies in volume. Reported volume data is compared with the North Dakota Industrial Commission's data to identify variances. Additionally, division orders and submitted royalty reports are reviewed to identify potential issues. These audit efforts have brought additional royalties due to the trusts that may not have otherwise been collected.

Starting in 2012, the Department began issuing notices of improper deductions to companies that reported deductions on royalty statements submitted for both oil and gas. The table below details

the results of these efforts.

## Royalty Activity FY 12 - FY 20

	FY 12	FY 13	FY 14	FY 15	FY 16
<b>Oil &amp; Gas Royalties</b>	\$ 203,791,379	\$ 275,822,135	\$ 371,629,760	\$ 317,194,842	\$ 179,086,533
<b>Additional Royalties Collected</b>	5,033,003	4,511,386	8,052,757	2,467,181	915,778
<b>Repaid Taxes &amp; Deductions</b>	541,319	743,283	248,958	471,200	353,256
<b>Penalties &amp; Interest Collected</b>	437,279	225,346	224,201	339,525	486,998
	FY 17	FY 18	FY 19	FY 20	9 YR Average
<b>Oil &amp; Gas Royalties</b>	\$ 192,039,448	\$ 293,350,591	\$ 321,908,210	\$ 238,441,014	\$ 269,504,930
<b>Additional Royalties Collected</b>	295,678	81,436	460,829	427,517	4,196,021
<b>Repaid Taxes &amp; Deductions</b>	42,580	797,882	-	710,011	471,603
<b>Penalties &amp; Interest Collected</b>	306,473	293,365	564,617	636,898	342,670

The table above details the actual dollars collected over the past nine fiscal years. The penalties and interest collected has not been substantial when compared to the royalty revenues that were assessed. Penalties and interest collected, when viewed as a percentage of the royalty revenues collected over the past nine fiscal years, was 0.13%.

HB 1080 was introduced at the request of the North Dakota Petroleum Council (NDPC) and was originally drafted to address its concerns with the Board's penalties and interest for late royalty payments.

The Board authorized the Commissioner to meet with the NDPC to work on drafting an amendment to HB 1080 agreeable to both parties. The parties were unable to agree on an amendment.

As currently drafted, version 21.0369.03000, the Board agrees to the language in the Section 1 amendment as proposed for 15-05-10(2), (3), and (4). Page 1, lines 19-24; Page 2, lines 1-23.

However, the Board is opposed to the Section 1 amendment as proposed for 15-05-10(5) which states:

If a lessee or the lessee's representative or assignee fails or refuses to comply with demands by the board to pay royalties, interest, or penalties under this chapter, the board may file an action to cancel the lease, recover unpaid royalties, and recover interest and penalties on the unpaid royalties. Notwithstanding chapter 28-01, an action under this subsection must be commenced within six years of the date oil or gas was produced under a lease. An action to cancel a lease, recover unpaid royalties, or recover interest or penalties on unpaid royalties may not be filed for production that occurred under a lease before August 1, 2015.

The Section 1 amendment as proposed for 15-05-10(5) has two separate issues that need to be addressed: (1) the statute of limitations set at six years, and (2) the retroactive application of the statute of limitations to August 1, 2015.

### **Statute of Limitations**

The six-year statute of limitations going forward would be difficult for the Board to conduct timely audits of all the royalty payers with current Department staffing levels. There are approximately 80 companies that pay royalties to the Board on over 8,200 oil and gas leases covering over 7,500 producing properties. In addition to auditing royalties, the Division is responsible for auditing bonuses, rents, and other revenues received by the Department, together with developing, implementing, and monitoring the managerial and system controls used by the Department to detect and prevent misappropriation of assets and revenues.

Texas and New Mexico, two states who conduct audits of oil and gas royalties, do not have a statute of limitations for royalties owed on state owned minerals. Recently, New Mexico experienced gas royalty payment issues. They executed settlement agreements to resolve affiliated gas contracts covering periods as far back as the 1980's. This is important to note as it is not uncommon for other states to have similar royalty issues and to make corrections going back decades.

The North Dakota Supreme Court has not yet ruled on the statute of limitations that applies to oil and gas royalties owed to the Board; however, it has ruled on a 10-year statute of limitations for private mineral owners. The Board believes the decision in Newfield v. State of North Dakota, Civil No. 27-2018-CV-00143 (McKenzie County District Court), will resolve the statute of limitations dispute.

### **Retroactive Application**

The Section 1 amendment as proposed for 15-05-10(5), as currently amended, creates a retroactive limitation for the collection of oil and gas royalties to August 1, 2015, or six years.

As will be discussed, the Board believes the bill as presently drafted raises constitutional issues.

The Board's concern with this section is similar to the NDPC's concern with SB 2217. NDPC's attorney Todd Kranda testified before this committee on February 8, 2021, stating "SB 2217, as introduced, would completely overturn the rights set forth in thousands of existing oil and gas contracts. Attempting to do so, not only would be dangerous policy and precedent, but it would implicate serious constitutional 'contract clause' concerns." Senator Scott Meyer similarly expressed this at the February 19, 2021 Senate floor debate when discussing Senate Bill 2217 and stated "it's not the legislature's role to be fighting private contract disputes . . . ."

The Board manages 13 permanent trusts created under Article IX of the North Dakota Constitution. The Board has entered into oil and gas lease contracts from which it has earned and is owed royalty payments upon the sale of the extracted minerals owned by these trusts. North Dakota Constitution Article IX, Section 1, requires "Revenues earned by a perpetual trust fund must be deposited in the fund." North Dakota Constitution Article IX, Section 2 goes on to state "no part of the fund must ever be diverted, even temporarily, from this purpose or used for any purpose other than the maintenance of common schools as provided by law." Passing a law limiting the collection of royalty payments owed to the permanent trusts conflicts with Article IX of North Dakota Constitution.

Assistant Attorney General Dave Garner is available to provide testimony regarding the constitutionality of this bill.

### **Communication History**

The topic of deductions, specifically gas deductions has been communicated to royalty payors as early as 1979. In response to receiving a draft version of the current lease in early 1979, payors expressed concern with the new royalty provisions, specifically, the deductibility of expenses. Many payors expressed the opinion that the new version of the lease did not allow for the deduction of expenses payors had historically taken. After the adoption of the new lease form in 1979, the Department conducted numerous audits during the late 1980's and early 1990's.

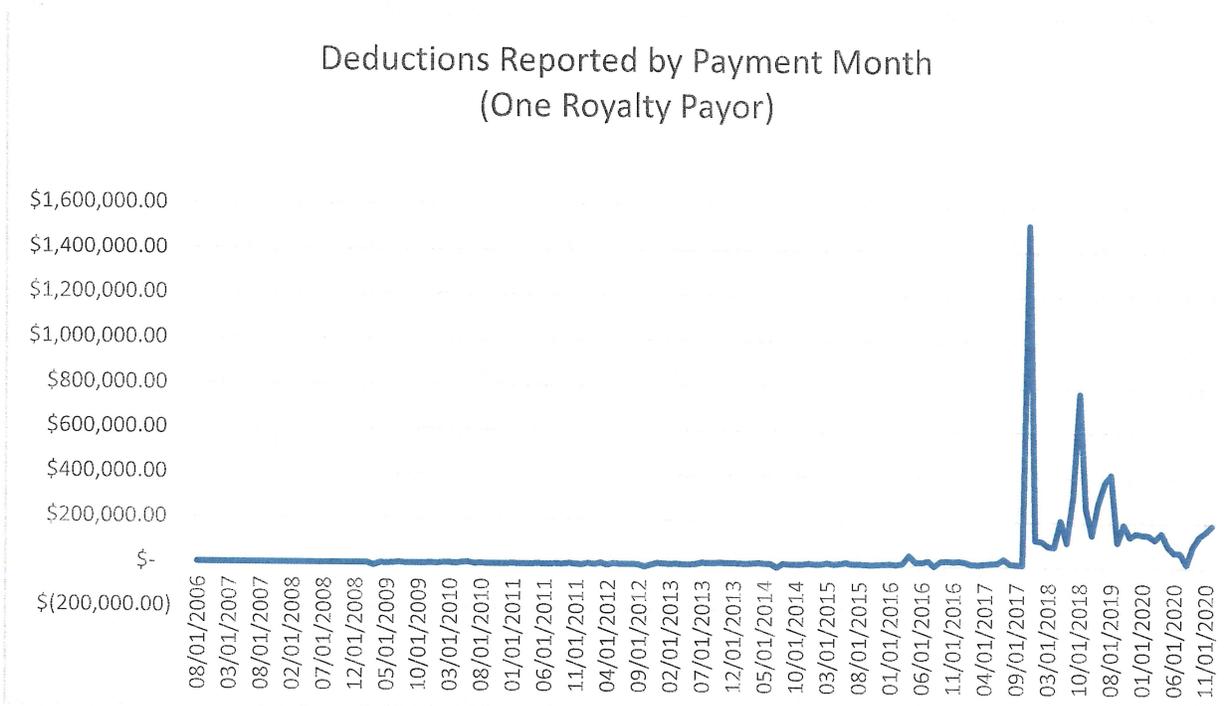
Many of the audits conducted by the Department throughout the years covered production periods for many years prior to the date of audit notification. For example, one audit completed in 1998 covered production from 1984 through 1991. After working through numerous issues with the operator, the Department resolved these issues and received payment in 2001. This is one instance where a company acknowledged inaccurate payments dating back many years and complied with correcting payment, evidencing the Board's long-standing practice of conducting audits and collecting royalty payments for time periods exceeding six years.

Shortly after the creation of the Division in 2011, the Department began issuing notices of improper deductions for both oil and gas royalties to companies that reported deductions as required by N.D.C.C. § 38-08-06.3. These notices covered periods back to January 2007 and clearly stated there should not be any deductions taken from either oil or gas royalties. If a royalty payor did not report deductions, they did not receive a notice.

The majority of royalty payors currently disputing deductions were most recently audited for production occurring from 2012-2014. During these audits it was discovered that many royalty payors were taking deductions that were not reported on their royalty statements. The Department and Board have had numerous communications with royalty payors regarding deduction concerns for both oil and gas royalties. Most of these royalty payors are not parties to litigation with the Board. If the proposed bill passes in its current form, the Board may only be able to collect underpaid royalties from production occurring after July 31, 2015, even though most royalty payors received notices and audit findings for periods prior to 2015. This could potentially cost the funds manage by the Board \$110 Million.

While working with industry to develop a new royalty reporting form in late 2014 and early 2015, the question of deductions was raised by many royalty payors. In conjunction with the issuance of its then new royalty reporting form in July 2015, Frequently Asked Questions (FAQs) were added to the Department's website. The FAQ's clearly state "Gross proceeds of sale means income before deduction of expenses . . . you may NOT deduct or 'net out' the expenses . . . ."

It is important to note, that in July 2017 letters were sent to all royalty payors and lessees regarding the proper method to calculate gas royalties. Some royalty payors, after receiving this letter, increased their reported gas deductions on a go forward basis and adjusted prior periods rather than working with the Department to resolve the issue. For example, the chart shown below, illustrates one royalty payor's gas deductions as reported to the Department. Through October 2017 this payor reported taking total cumulative deductions of \$678,712 for gas. Since then this payor has reported an average of \$228,643 each month.



With consistent and continuous messaging to royalty payors, the Board continues to have royalty payors who are out of compliance. Currently, the Board has authorized a waiver of penalty and an interest of prime plus 4%. Even with this offer, there are royalty payors who are out of compliance. Additionally, there are operators who have communicated with the Department they do not intend to work with the Department to enter into compliance until the Newfield case is resolved.

In addition to the Newfield litigation regarding payment of gas royalties, the Board is also party to litigation with Continental Resources. That case relates to the proper payment of both oil and gas royalty payments.

The Board is only in litigation with Continental and Newfield. There are currently 30 gas royalty payors and 10 oil royalty payors out of compliance with the Board (these numbers include Continental and Newfield). Again, the Board and the Department have attempted to work with these companies to resolve any dispute for nearly a decade.

In summary, the Board does not support HB 1080 in its current form, specifically the Section 1 amendment as proposed for 15-05-10(5). The Board recommends removal of any reference to retroactive application and a statute of limitations as to the collection of funds owed. The Board believes the Court's decision in Newfield will address special defenses governing past due royalty payments including the applicable statute of limitations.

We look forward to working with the Committee on these issues and would be happy to answer any questions.

# 2021 SENATE STANDING COMMITTEE MINUTES

## Energy and Natural Resources Committee Peace Garden Room, State Capitol

HB 1080  
3/18/2021

A BILL for an Act to amend and reenact sections 15-05-10 and 47-16-39.1 of the North Dakota Century Code, relating to the obligation to pay oil and gas royalties on leases owned and managed by the board of university and school lands.

Hearing called to order all Senators Present: **Roers, Bell, Schaible, Piepkorn, Patten, and Kreun.** [9:44]

### Discussion Topics:

- Unpaid Audit Invoices
- Land Board oversight abilities

**Senator Patten** moved to amend with  
L.C. 21.0369.03001 [9:44] **Senator**  
**Bell** seconded the motion Motion  
Passed 4-2-0

VOTE TO AMEND HB 1080	Vote
Senator Curt Kreun	Y
Senator Jim P. Roers	N
Senator Dale Patten	Y
Senator Merrill Piepkorn	Y
Senator Donald Schaible	N
Senator Jessica Unruh Bell	Y

**Senator Schaible** moved A DO PASS AS  
AMENDED [9:45]

**Senator J. Roers** seconded the motion  
Vote Passed 6-0-0  
Senator Patten Carried

DO PASS AS AMENDED HB 1080	Vote
Senator Curt Kreun	Y
Senator Jim P. Roers	Y
Senator Dale Patten	Y
Senator Merrill Piepkorn	Y
Senator Donald Schaible	Y
Senator Jessica Unruh Bell	Y

Hearing Adjourned [9:46]

*Sheila Froehlich, Committee Clerk*

21.0369.03001  
Title.04000

Prepared by the Legislative Council staff for  
Senator Patten

March 17, 2021

3/18  
1021

PROPOSED AMENDMENTS TO ENGROSSED HOUSE BILL NO. 1080

Page 2, line 28, replace "six" with "seven"

Page 2, line 31, replace "2015" with "2013"

Renumber accordingly

**REPORT OF STANDING COMMITTEE**

**HB 1080, as engrossed: Energy and Natural Resources Committee (Sen. Kreun, Chairman) recommends AMENDMENTS AS FOLLOWS and when so amended, recommends DO PASS (6 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). Engrossed HB 1080 was placed on the Sixth order on the calendar.**

Page 2, line 28, replace "six" with "seven"

Page 2, line 31, replace "2015" with "2013"

Renumber accordingly

**2021 SENATE APPROPRIATIONS**

**HB 1080**

# 2021 SENATE STANDING COMMITTEE MINUTES

**Appropriations Committee**  
Roughrider Room, State Capitol

HB 1080  
3/30/2021  
Senate Appropriations Committee

Relating to the obligation to pay oil and gas royalties on leases owned and managed by the board of university and school lands.
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**Senator Holmberg** opened the hearing at 3:03 PM.

Senators present: **Holmberg, Krebsbach, Wanzek, Bekkedahl, Poolman, Erbele, Dever, Oehlke, Rust, Davison, Hogue, Sorvaag, Mathern, and Heckaman.**

**Discussion Topics:**

- Royalty payments
- 7-year statute of limitations

**Representative Jason Dockter, District 7** – introduced the bill.

**Levi Kinnischtzke, Legislative Council** – testified neutrally.

**Ron Ness, President, North Dakota Petroleum Council** – testified in favor.

**Jodi Smith, Commissioner, Board of University and School Lands** – testified in favor and submitted testimony #11079.

**Senator Holmberg** closed the hearing at 3:29 PM.

*Rose Laning, Committee Clerk*



**TESTIMONY OF JODI SMITH  
COMMISSIONER  
North Dakota Department of Trust Lands  
House Bill 1080  
Senate Appropriations Committee  
March 30, 2021**

Chairman Holmberg and members of the Senate Appropriations Committee (Committee), I am Jodi Smith, the Commissioner and Secretary for the Board of University and School Lands (Board). I am here to testify on House Bill 1080.

HB 1080 creates a separate subsection to N.D.C.C. § 15-05-10 relating to the royalties from oil and gas leases owned and managed by the Board. HB 1080 has been amended since it was first introduced in the House of Representatives to include amendments the NDPC and the Board have agreed upon. As currently drafted, version 21.0369.04000, the Board agrees to the language in the Section 1 amendment as proposed for 15-05-10(2), (3), and (4).

Paragraph 2 – Maximum Interest

Currently, in N.D.C.C. § 47-16-39.1, the statute states the maximum rate of interest the Board can assess to payors for late royalty payments is eighteen percent. Under HB 1080, this provision would be moved to N.D.C.C. § 15-05-10(2) and cap the late royalty payment interest rate at nine percent.

Paragraph 3 – Maximum Penalty

Currently, in the Board's lease and N.D.A.C. § 85-06-01-12 the maximum rate of penalty the Board can assess to payors for late royalty payments is twelve percent. Under HB 1080, this would be addressed in N.D.C.C. § 15-05-10(3), with a cap the late royalty payment penalty rate at six percent.

Paragraph 4 – Payment Under Protest

Currently, the Board does not allow for payment under protest for royalty disputes. Under HB 1080, the payor may submit payment under protest to stop the accrual of interest and penalties owed to the Board. Additionally, if it is determined that the payment of the disputed amount results in an overpayment, the party who made the overpayment is entitled to a refund of the overpayment amount plus interest at the rate established under N.D.C.C. § 28-20-34.

However, the Board is opposed to the Section 1 amendment as proposed for 15-05-10(5) which states:

If a lessee or the lessee's representative or assignee fails or refuses to comply with demands by the board to pay royalties, interest, or penalties under this chapter, the board may file an action to cancel the lease, recover unpaid royalties, and recover interest and penalties on the unpaid royalties. Notwithstanding chapter 28-01, an action under this subsection must be commenced within seven years of the

date oil or gas was produced under a lease. An action to cancel a lease, recover unpaid royalties, or recover interest or penalties on unpaid royalties may not be filed for production that occurred under a lease before August 1, 2013.

Page 2, lines 24-31.

The Section 1 amendment as proposed for 15-05-10(5) has two separate issues that potentially have a financial impact: (1) the statute of limitations set at seven years, and (2) the retroactive application of the statute of limitations to August 1, 2013.

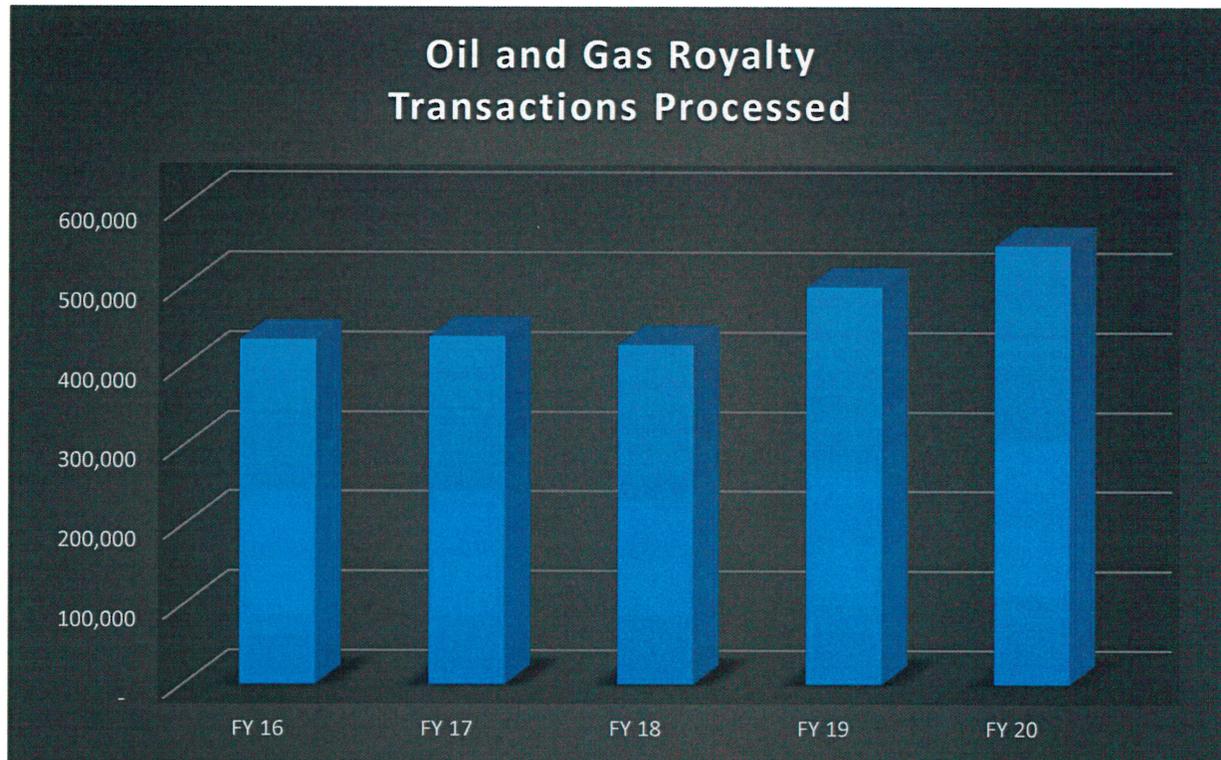
### **Statute of Limitations**

While the Department of Trust Lands (Department) has a long standing history of auditing, dating back to 1922, the Board began a concerted effort of auditing oil and gas royalties in the 1980's. Audits performed in the 1980's were primarily related to oil and gas royalties owed under leases issued prior to 1979, which have different terms than leases issued after 1979. These audits resulted in the Board collecting additional royalties dating back to as early as the 1950's. Through the decades, the Board has persistently worked with industry partners to collect payment or establish escrow accounts for royalties from the production of minerals, in accordance with the North Dakota Century Code, the Board's lease, rules, and policies.

Between 2006 and 2011, the Board saw a 240% increase in the number of producing wells, which tripled the number of royalty records that needed to be processed. A formal Revenue Compliance Division (Division) was created in March 2011 upon Legislative approval of the hiring of two staff. Today, the Division has four dedicated FTEs who are responsible for developing and implementing procedures to assure the timely and accurate accounting of all royalties, bonuses, rentals, and other revenues received, with a significant amount of time being dedicated to evaluating the accounting and collection of oil and gas royalties. Overall, the Division is responsible for:

1. Managing collections of royalties and surface payments
2. Monitoring and developing internal controls
3. Ensuring accurate setup and transfers of funds for investment purposes
4. Tracking of escrowed funds
5. Assisting with the drafting of leases, rules, easements, or any other financial agreements
6. Participating in the drafting legal pleadings
7. Reviewing unclaimed property claims over \$2,500

A significant portion of the Divisions efforts are dedicated auditing royalty transactions. Royalty transactions include prior period adjustments and current period payments. Often, multiple transactions will occur on the same statement for the same property due to multiple tracts in the same spacing unit, reporting of various products, and prior period adjustments.



Royalty data is reviewed for ownership, valuation, and discrepancies in volume. Reported volume data is compared with the North Dakota Industrial Commission's data to identify variances. Additionally, division orders and submitted royalty reports are reviewed to identify potential issues. These audit efforts have brought additional royalties owed to the trusts that may not have otherwise been collected.

The seven-year statute of limitations going forward would be difficult for the Board to conduct timely audits of all the royalty payers with current Department staffing levels. There are approximately 80 companies that pay royalties to the Board on over 8,200 oil and gas leases covering over 7,500 producing properties. In order to conduct audits in a timely manner within the seven-year statute of limitations, the Department will need an additional auditor. It is estimated this will cost approximately \$300,000 per biennium.

The State Auditor's Office currently has four auditing FTEs in the Federal Mineral Audit Division who are dedicated to just auditing Federal oil and gas royalties' reporting revenues of \$168 million during 2020 on roughly 5,000 properties. Comparatively during the same time period, the Department received \$193 million in oil and gas royalties on 7,500 properties with only three auditing FTEs.

### **Retroactive Application**

The Section 1 amendment as proposed for 15-05-10(5), creates a retroactive limitation for the collection of oil and gas royalties to August 1, 2013, or eight years. The potential lost revenue due to this section is estimated to be \$69.4 million during the 2021-2023 biennium. Additionally, by not collecting the revenue owed the impacted trusts/funds investment earnings will also be reduced. The compounding interest not earned on lost revenue of \$69.4 million is estimated at \$9 million for the 2023-2025 biennium. By 2031, the amount of lost revenue, with compounding

interest, is estimated to be \$130 million. By 2038, this will be over \$200 million lost revenue for the trusts.

As will be discussed, the Board believes the bill as presently drafted raises constitutional issues.

The Board manages 13 permanent trusts created under Article IX of the North Dakota Constitution. The Board has entered into oil and gas lease contracts from which it has earned and is owed royalty payments upon the sale of the extracted minerals owned by these trusts. North Dakota Constitution Article IX, Section 1, requires "Revenues earned by a perpetual trust fund must be deposited in the fund." North Dakota Constitution Article IX, Section 2 goes on to state "no part of the fund may ever be diverted, even temporarily, from this purpose or used for any purpose other than the maintenance of the institution, as provided by law." Passing a law limiting the collection of royalty payments owed to the permanent trusts conflicts with Article IX of the North Dakota Constitution.

Supporting this position on the legislative website there is a PDF file containing the Enabling Act (<https://www.legis.nd.gov/constit/theenablingact.pdf>) paragraph four on page six of this document cites to *State ex rel. Sathre v. Board of University & School Lands*, 262 N.W. 60 (N.D. 1935), states "The assembly cannot divert nor authorize diversion of any part of the principal or interest or income from the investment of funds under the control of the board of university and school lands arising from the rental or sale of lands granted by the United States to any purposes other than those for which grants were made and any diversion to other purposes or any donation thereof in aid of an individual, by the assembly directly, or by the board of university and school lands by legislative enactment is unconstitutional."

Assistant Attorney General Dave Garner is available to provide testimony regarding the constitutionality of this bill.

### **Communication History**

The topic of deductions, specifically gas deductions has been communicated to royalty payors as early as 1979. In response to receiving a draft version of the current lease in early 1979, payors expressed concern with the new royalty provisions, specifically, the deductibility of expenses. Many payors expressed the opinion that the new version of the lease did not allow for the deduction of expenses payors had historically taken. After the adoption of the new lease form in 1979, the Department conducted numerous audits during the late 1980's and early 1990's.

Many of the audits conducted by the Department throughout the years covered production periods for many years prior to the date of audit notification. For example, one audit completed in 1998 covered production from 1984 through 1991. After working through numerous issues with the operator, the Department resolved these issues and received payment in 2001. This is one instance where a company acknowledged inaccurate payments dating back many years and complied with correcting payment, evidencing the Board's long-standing practice of conducting audits and collecting royalty payments for time periods exceeding seven years.

Shortly after the creation of the Division in 2011, the Department began issuing notices of improper deductions for both oil and gas royalties to companies that reported deductions as required by N.D.C.C. § 38-08-06.3. These notices covered periods back to January 2007 and clearly stated there should not be any deductions taken from either oil or gas royalties. If a royalty payor did not report deductions, they did not receive a notice.

Starting in 2012, the Department began issuing notices of improper deductions to companies that reported deductions on royalty statements submitted for both oil and gas. The table below details the results of these efforts.

### Royalty Activity FY 12 - FY 20

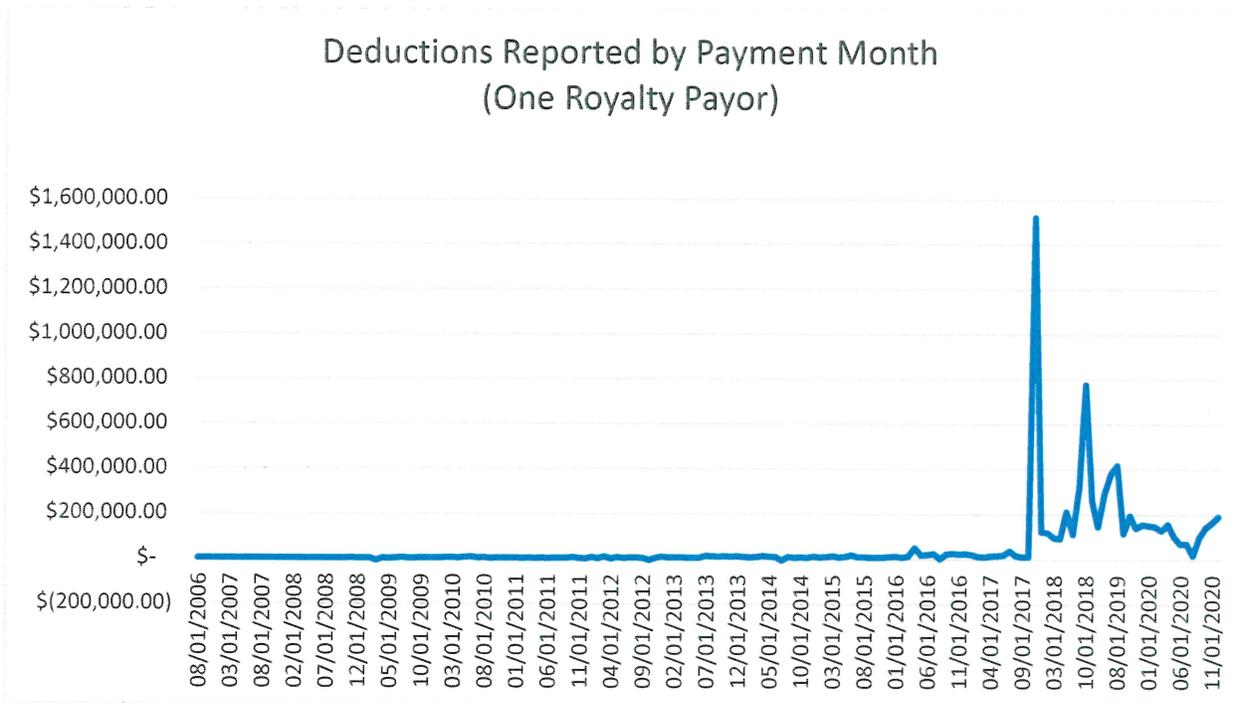
	FY 12	FY 13	FY 14	FY 15	FY 16
<b>Oil &amp; Gas Royalties</b>	\$ 203,791,379	\$ 275,822,135	\$ 371,629,760	\$ 317,194,842	\$ 179,086,533
<b>Additional Royalties Collected</b>	5,033,003	4,511,386	8,052,757	2,467,181	915,778
<b>Repaid Taxes &amp; Deductions</b>	541,319	743,283	248,958	471,200	353,256
<b>Penalties &amp; Interest Collected</b>	437,279	225,346	224,201	339,525	486,998
	FY 17	FY 18	FY 19	FY 20	9 YR Average
<b>Oil &amp; Gas Royalties</b>	\$ 192,039,448	\$ 293,350,591	\$ 321,908,210	\$ 238,441,014	\$ 269,504,930
<b>Additional Royalties Collected</b>	295,678	81,436	460,829	427,517	4,196,021
<b>Repaid Taxes &amp; Deductions</b>	42,580	797,882	-	710,011	471,603
<b>Penalties &amp; Interest Collected</b>	306,473	293,365	564,617	636,898	342,670

The table above details the actual dollars collected over the past nine fiscal years. The penalties and interest collected have not been substantial when compared to the royalty revenues that were assessed. Penalties and interest collected, when viewed as a percentage of the royalty revenues collected over the past nine fiscal years, amounted to 0.13%.

The majority of royalty payors currently disputing deductions were most recently audited for production occurring from 2012-2014. During these audits it was discovered that many royalty payors were taking deductions that were not reported on their royalty statements. The Department and Board have had numerous communications with royalty payors regarding deduction concerns for both oil and gas royalties. Most of these royalty payors are not parties to litigation with the Board. If the proposed bill passes in its current form, the Board may only be able to collect underpaid royalties from production occurring after July 31, 2013, even though most royalty payors received notices and audit findings for periods prior to 2013. This could potentially cost the funds managed by the Board \$69.4 million.

While working with industry to develop a new royalty reporting form in late 2014 and early 2015, the question of deductions was raised by many royalty payors. In conjunction with the issuance of its then new royalty reporting form in July 2015, Frequently Asked Questions (FAQs) were added to the Department's website. The FAQ's clearly state "Gross proceeds of sale means income before deduction of expenses . . . you may NOT deduct or 'net out' the expenses . . . ."

It is important to note, that in July 2017 letters were sent to all royalty payors and lessees regarding the proper method to calculate gas royalties. Some royalty payors, after receiving this letter, increased their reported gas deductions on a go forward basis and adjusted prior periods rather than working with the Department to resolve the issue. For example, the chart shown below, illustrates one royalty payor's gas deductions as reported to the Department. Through October 2017 this payor reported taking total cumulative deductions of \$678,712 for gas. Since then this payor has reported an average of \$228,643 each month.



With consistent and continuous messaging to royalty payors, the Board continues to have royalty payors who are out of compliance. Currently, the Board has authorized a waiver of penalty and an interest rate of prime plus 4%. Even with this offer, there are royalty payors who are out of compliance. Additionally, there are operators who have communicated with the Department they do not intend to work with the Department to enter into compliance until the Newfield case is resolved.

In addition to the Newfield litigation regarding payment of gas royalties, the Board is also party to litigation with Continental Resources. That case relates to the proper payment of both oil and gas royalty payments.

The Board is only in litigation with Continental and Newfield. There are currently 30 gas royalty payors and 10 oil royalty payors out of compliance with the Board (these numbers include Continental and Newfield). Again, for nearly a decade, the Board and the Department have attempted to work with these companies to resolve any dispute.

In summary, the Board does not support HB 1080 in its current form, specifically the Section 1 amendment as proposed for 15-05-10(5) retroactive application. As outlined in the fiscal note attached to the bill, the implementation of this section will cost the funds managed by the Board an estimated \$69.4 during the next biennium. The Board recommends removal of any reference to retroactive application and a statute of limitations as to the collection of funds owed. The Board believes the Court's decision in Newfield will address special defenses governing past due royalty payments including the applicable statute of limitations. Additionally, the Department is seeking an additional FTE to meet the obligations arising from the seven year statute of limitations.

We look forward to working with the Committee on these issues and would be happy to answer any questions.

# 2021 SENATE STANDING COMMITTEE MINUTES

## Appropriations Committee Roughrider Room, State Capitol

HB 1080

4/7/2021

Senate Appropriations Committee

Relating to the obligation to pay oil and gas royalties on leases owned and managed by the board of university and school lands.
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**Senator Holmberg** opened the committee work at 11:07 AM.

Senators present: **Holmberg, Krebsbach, Wanzek, Bekkedahl, Poolman, Erbele, Dever, Oehlke, Rust, Davison, Hogue, Sorvaag, Mathern, and Heckaman.**

### Discussion Topics:

- Vote

Senator Wanzek moved Do Pass on HB 1080.

Senator Erbele second.

<b>Senators</b>		<b>Senators</b>	
<i>Senator Holmberg</i>	Y	<i>Senator Hogue</i>	Y
<i>Senator Krebsbach</i>	Y	<i>Senator Oehlke</i>	Y
<i>Senator Wanzek</i>	Y	<i>Senator Poolman</i>	Y
<i>Senator Bekkedahl</i>	Y	<i>Senator Rust</i>	Y
<i>Senator Davison</i>	Y	<i>Senator Sorvaag</i>	Y
<i>Senator Dever</i>	Y	<i>Senator Heckaman</i>	N
<i>Senator Erbele</i>	Y	<i>Senator Mathern</i>	N

Roll Call vote 12-2-0 Motion passed.

**Senator Holmberg** closed the committee work at 11:11 AM.

*Rose Laning, Committee Clerk*

**REPORT OF STANDING COMMITTEE**

**HB 1080, as engrossed and amended: Appropriations Committee (Sen. Holmberg, Chairman)** recommends **DO PASS** (12 YEAS, 2 NAYS, 0 ABSENT AND NOT VOTING). Engrossed HB 1080, as amended, was placed on the Fourteenth order on the calendar.