

Introduced by

Senators Bekkedahl, Dwyer, Kannianen

Representatives Brandenburg, Kempenich, Zubke

1 A BILL for an Act to create and enact section 47-16-39.5 of the North Dakota Century Code,  
2 relating to oil and gas royalty leases, negative royalties, and arm's length transactions; and to  
3 provide a penalty.

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

5 **SECTION 1.** Section 47-16-39.5 of the North Dakota Century Code is created and enacted  
6 as follows:

7 **47-16-39.5. Definitions - Royalty lease - Penalty.**

8 1. As used in this section:

- 9 a. "Arm's length transaction" means a transaction between parties with adverse  
10 economic interests in which each party to the transaction is in a position to  
11 distinguish its economic interest from that of the other party. The term does not  
12 include a transaction made:  
13 (1) By a corporation or other entity with itself, or a parent, subsidiary, or  
14 interrelated corporation or entity;  
15 (2) Between partners or co-joint venturers; or  
16 (3) Between corporations or other entities having interlocking directorships or  
17 close business relationships that may compromise their individual interests.  
18 b. "Overriding royalty" means a right to oil, gas, and other minerals in place or as  
19 produced which entitles the owner of the right to a specified fraction of production  
20 without limitation to a specified amount of money or a specified number of units  
21 of oil, gas, or other minerals.  
22 c. "Royalty" means the mineral owner's share of production.

1           d. "Royalty owner" means a person that owns a royalty interest and is entitled to  
2           receive periodic royalty payments for a nonworking interest in the production of  
3           oil or gas or in the severance of other minerals from the mineral estate.

4           2. Except for taxes imposed under chapters 57-51 and 57-51.1, the deduction of  
5           postproduction costs from royalty payments is prohibited unless the lease contract  
6           explicitly allows for the deduction of postproduction costs. If an overriding royalty  
7           contract explicitly allows for the deduction of postproduction costs, the deduction only  
8           applies to the overriding royalty interest fraction.

9           3. The sale value upon which a royalty or overriding royalty is calculated must be based  
10          upon an arm's length transaction. A non-arm's length transaction or a transaction in  
11          which a seller retains an interest beyond the purported sales point are disregarded  
12          unless the oil and gas lease or overriding royalty contract explicitly allows otherwise.

13          4. If a lease allows for deductions, the costs deducted from royalty or overriding royalty  
14          income may not exceed the income earned from the wells for the corresponding  
15          production month for the specific product. Costs in excess of income from a specific  
16          production month may not be carried forward or backward to any other production  
17          month. A violation of this subsection is a class B misdemeanor.

18          5. A royalty owner or overriding royalty owner may audit the records of the oil and gas  
19          operator obligated to pay royalties under the lease for compliance with the  
20          requirements of this section. Any audited records must be provided in accordance with  
21          section 47-16-39.2. The costs of auditing must be paid by the royalty or overriding  
22          royalty owner requesting the audit and the operator shall make all reasonable  
23          accommodations to provide documentation to verify the income and costs reflected in  
24          the royalty owner and overriding royalty owner payments.

25          6. A noncompliant party that violates this section is guilty of a class B misdemeanor for  
26          each violation and is subject to a civil penalty. If the royalty owner or the royalty  
27          owner's designated representative is successful in a proceeding brought under this  
28          section, the district court shall allow the royalty owner or the royalty owner's  
29          designated representative to recover all underpaid royalties, court costs, reasonable  
30          costs, fees, disbursements, reasonable attorney's fees, and expenses incurred by the  
31          royalty owner or the royalty owner's designated representative from the party obligated

- 1 to pay royalties under the lease. The district court also shall assess a civil penalty not
- 2 exceeding ten thousand dollars for each violation of this section.