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Sixty-seventh Legislative Assembly of North Dakota

SENATE BILL NO. 2217

Introduced by

Senators Bekkedahl, Dwyer, Kannianen

Representatives Brandenburg, Kempenich, Zubke

A BILL ~~for an Act to create and enact section 47-16-39.5 of the North Dakota Century Code, relating to oil and gas royalty leases, negative royalties, and arm's length transactions; and to provide a penalty.~~for an Act to create and enact a new section to chapter 47-16 of the North Dakota Century Code, relating to the deduction or recovery of losses incurred in the sale or disposition of natural gas from the proceeds of oil production; and to provide for a legislative management study.

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF NORTH DAKOTA:

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

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

~~1. As used in this section:~~

~~a. "Arm's length transaction" means a transaction between parties with adverse economic interests in which each party to the transaction is in a position to distinguish its economic interest from that of the other party. The term does not include a transaction made:~~

~~(1) By a corporation or other entity with itself, or a parent, subsidiary, or interrelated corporation or entity;~~

~~(2) Between partners or co-joint venturers; or~~

~~(3) Between corporations or other entities having interlocking directorships or close business relationships that may compromise their individual interests.~~

~~b. "Overriding royalty" means a right to oil, gas, and other minerals in place or as produced which entitles the owner of the right to a specified fraction of production without limitation to a specified amount of money or a specified number of units of oil, gas, or other minerals.~~

~~c. "Royalty" means the mineral owner's share of production.~~

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

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

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

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

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

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

~~royalty owner or the royalty owner's designated representative from the party obligated to pay royalties under the lease. The district court also shall assess a civil penalty not exceeding ten thousand dollars for each violation of this section.~~

SECTION 1. A new section to chapter 47-16 of the North Dakota Century Code is created and enacted as follows:

Certain deductions prohibited - Breach.

1. The deduction or recovery of losses incurred in the sale or disposition of natural gas produced under an oil and gas lease from the proceeds of oil production attributable to royalty interests or overriding royalty interests under the lease is prohibited unless expressly and unambiguously provided otherwise by the lease, provided the losses:
   a. May be offset or applied against a subsequent net gain in the sale or disposition of natural gas in accordance with the lease;
   b. May not be offset by the gains from one well to another well; and
   c. May not be carried forward from one well to the gains or losses of another well.
2. A person found to be in violation of subsection 1, if lease cancellation is not sought, shall pay interest at the applicable annual rate set by the state court administrator pursuant to section 28-20-34 on the portion of oil or gas royalties that were not timely paid to the owner of the royalties on account of the violation until paid. The district court for the county in which the oil or gas well is located has jurisdiction over all proceedings brought under this section. The prevailing party in any proceeding under this section is entitled to recover any court costs and reasonable attorney's fees.

SECTION 2. LEGISLATIVE MANAGEMENT STUDY - POSTPRODUCTION COST DEDUCTIONS. During the 2021-22 interim, the legislative management shall consider studying deductions for postproduction costs under oil and gas leases.

1. The study must include:
   a. Consideration of the methods used to calculate the value of oil and gas, the point of sale used to determine the value, oil and gas sales in the absence of an arm's-length contract, any deductions or incentives applied to the value, and the methods used to report any deductions or incentives on mineral royalty statements;

b. Input from representatives from the oil and gas industry, representatives from an organization representing royalty owners, the department of mineral resources, the department of trust lands, and the attorney general's office; and

c. An analysis and review of state-mandated natural gas capture targets, federal land permitting restrictions, the effectiveness of using onsite flare mitigation technologies and the infrastructure necessary to enhancing oil and natural gas value.

2. The study may include consideration of the desirability and feasibility of expanding the use and market access of natural gas, including value-added energy opportunities within the state.

3. The legislative management shall report its findings and recommendations, together with any legislation required to implement the recommendations, to the sixty-eighth legislative assembly.