



100 West Broadway, Ste. 200 | P.O. Box 1395 | Bismarck, ND 58501-1395
701.223.6380 | ndpc@ndoil.org | www.NDOil.org

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.