

COMPREHENSIVE ENERGY POLICY STUDY

The Energy Development and Transmission Committee was created in 2007 by House Bill No. 1462 and was codified in North Dakota Century Code (NDCC) Section 54-35-18. The committee replaced the Electric Industry Competition Committee and has a broader scope of study. The committee must study the impact of a comprehensive energy policy for the state and the development of each facet of the energy industry, from the obtaining of the raw natural resources to the sale of the final product in this state, other states, and other countries. The study may include the review of and recommendations relating to policy affecting extraction, generation, processing, transmission, transportation, marketing, distribution, and use of energy and the taxation of shallow gas. The statute establishing the committee expires on August 1, 2011.

In addition to the statutory responsibilities, the Legislative Management assigned three studies relating to wind to this committee. These studies are contained in House Bill Nos. 1449 and 1509 and House Concurrent Resolution No. 3044.

House Bill No. 1449, Section 3, requires the study of wind resources and other natural resources in the same location. The study must include a review of laws relating to the siting and decommissioning of a wind energy conversion facility, the desirability of an environmental assessment as a condition of siting, and the desirability of regulation of wind energy conversion facilities to address the effects on water, soil, cultural resources, and future development of other natural resources.

House Bill No. 1509, Section 2, directs the study of wind easements and wind energy leases, including a consideration of confidentiality clauses, liability for damages and taxes, insurance, and other concerns of property owners and wind developers.

House Concurrent Resolution No. 3044 directs a study of wind rights. In particular, the resolution suggests defining wind rights by connecting wind rights to the surface estate and protecting adjacent property rights through setbacks.

To avoid duplication, this committee may wish to avoid studying areas being studied by other interim committees. The interim Natural Resources Committee is studying House Concurrent Resolution No. 3045, which directs a study of severed and abandoned mineral rights and methods to reduce the discount for oil produced in this state.

The interim Taxation Committee is studying Senate Bill No. 2051, Section 2, which directs a study of mineral production impact and taxation issues, including development of relatively new industries for extraction and production of minerals such as uranium, potash, and other minerals not previously produced on a significant economic scale; the

economic, environmental, and governmental impact; infrastructure maintenance; employment issues; tax structures in North Dakota and other states; and water demands relating to mineral production.

ENERGY POLICY

In an effort to create a comprehensive energy policy, the Legislative Assembly passed House Bill No. 1462 (2007) creating NDCC Title 17. Title 17 was created in part by moving sections of the Century Code already in existence into Title 17. Title 17 includes what was formerly Sections 4-14.1-07.1, 4-14.1-07.2, 4-14.1-08, 4-14.1-09, and 4-14.1-10, relating to ethanol plant production incentives from the ethanol production incentive fund; Chapter 6-09.17, relating to the biodiesel partnership in assisting community expansion (PACE) fund being used for interest rate buydowns on loans to biodiesel production facilities; Section 9-01-22, relating to the termination of a wind option agreement; Sections 47-05-14 through 47-05-16, relating to the creation of wind easements and termination for lack of development; Section 47-16-42, relating to the termination of a wind energy lease for lack of development; and Chapter 49-24, relating to the North Dakota Transmission Authority.

In 2007, House Bill No. 1462 created the 25x'25 initiative for inclusion in NDCC Section 17-01-01. This initiative adopts the goal of having the agricultural, forestry, and working lands of the United States provide from renewable resources not less than 25 percent of the total energy consumed in the United States by January 1, 2025. The initiative defines renewable energy to include biofuels, solar, wind, hydropower, geothermal, carbon recycling, carbon sequestration, use of waste heat, recycling, low emissions technologies that create or use hydrogen, and energy efficiency initiatives.

In 2009 the Legislative Assembly made a number of changes to provisions in NDCC Title 17 and created new provisions in Title 17. Four bills created major new law in Title 17. These bills include Senate Bill Nos. 2350 and 2228 and House Bill Nos. 1509 and 1322.

Senate Bill No. 2350 created the North Dakota Ethanol Council consisting of members appointed by a facility located in this state which produces more than 1 million gallons of agriculturally derived denatured ethanol. The council is charged with expending money collected through an assessment at the rate of thirty-one hundredths of 1 percent per gallon imposed upon all ethanol produced and sold in this state for the purpose of funding research, education programs, promotion, and market development efforts and state, regional, national, and international entities that promote ethanol utilization.

In addition, the bill provides for a refund of the assessment, a continuing appropriation for the assessment, and a penalty of a Class B misdemeanor for a person violating calculation and submission provisions of the assessment.

Senate Bill No. 2228 requires the Department of Commerce to administer the biofuel blender pump incentive fund. The fund is to be used to provide cost-share grants of up to \$5,000 per pump for the installation of biofuel blender pumps to retailers who qualify and install pumps that dispense at retail a blend of gasoline and ethanol in a ratio selected by the purchaser and have at least four hoses that include a hose that dispenses E-10, a blend of at least E-20, and E-85 fuel.

House Bill No. 1509 requires a wind easement and a wind energy lease to contain certain warnings; to allow time for the document to be reviewed and discussed with an attorney or other landowners; to prohibit a property owner from being liable for property taxes associated with a wind energy facility; to prohibit a property owner for being liable for damages caused by the wind energy facility; to prohibit making the property owner liable for a violation of law or regulation; to allow the property owner to terminate the agreement if the wind energy facility has not operated for a period of at least three years; to state circumstances that will allow the developer, owner, and operator of the wind energy facility to withhold payments; to require the owner of a wind energy facility to carry general liability insurance; and to allow for judicial relief. In addition, the bill provides for a study of wind easements and wind energy leases which is being conducted by this committee and was discussed earlier in this memorandum.

House Bill No. 1462 (2007) required the Department of Commerce to convene an energy policy commission for developing a comprehensive energy policy as part of the North Dakota energy independence initiative. The purpose for this policy was to:

1. Stimulate the development of renewable and traditional fossil-based energy within the state with the goal of providing secure, diverse, sustainable, and competitive energy supplies to reduce the dependence on foreign energy sources.
2. Promote the development of new technologies to decrease dependence on foreign energy supplies.
3. Address the growth of fossil fuel and renewable energy industries to encourage the state's competitiveness.
4. Address research, development, and marketing of North Dakota-produced energy.
5. Address the expansion of existing energy resources and the diversification of this state's energy resource base.
6. Evaluate existing tax credits and incentives.
7. Modernize and expand this state's energy infrastructure.

8. Examine potential innovations to improve environmental conditions through new technologies and review energy industry workforce and training needs and develop a strategy to maximize the state's market opportunities.

In 2009 the Energy Policy Commission was codified in NDCC Section 17-07-01 through House Bill No. 1322. The purpose of the commission is to develop a comprehensive energy policy, update that policy, and monitor progress in reaching the goals of the policy. The Energy Policy Commission consists of the Commissioner of Commerce, as chairman, and members appointed by the Governor to represent the agricultural community, the Lignite Energy Council, the North Dakota Petroleum Council, the biodiesel industry, the biomass industry, the wind industry, the ethanol industry, the North Dakota Petroleum Marketers Association, the North Dakota investor-owned electric utility industry, the generation and transmission electric cooperative industry, the lignite coal-producing industry, the refining or gas processing industry, and additional nonvoting members. In short, the Energy Policy Commission is studying a comprehensive energy policy and the same issue is being studied by this committee.

In addition to NDCC Title 17, the Legislative Assembly has adopted a number of concurrent resolutions relating to energy policy since 2007. In 2009 the Legislative Assembly adopted House Concurrent Resolution Nos. 3030 and 3039. House Concurrent Resolution No. 3030 urged Congress to use common sense principles for climate change legislation. These principles included that federal action should not impede economic growth, new job creation, or lower the standard of living; should be fully transparent so that consumers are aware of potential economic impacts; should provide encouragement for research and development; should allow cost recovery; should tie greenhouse gas reduction requirements to scientifically based technology that is available, reliable, and economically feasible; should recognize and protect existing and past investment decisions for generation resources; should allow development of resources in the United States; and should recognize the worldwide scope of the issue. House Concurrent Resolution No. 3039 urged the President and Congress to develop energy resources on the Outer Continental Shelf, promote domestic energy production, and to not impose additional taxes on America's energy producers.

2009 LEGISLATION

There were numerous bills introduced during the 2009 legislative session that relate to energy. The bills are classified by the headings of taxation, governmental entity, and other bills. In addition, one constitutional measure was approved for the general election in 2011. Some bills are classified in multiple categories and these will be noted with an asterisk.

Taxation

The taxation category is divided into property taxes, income taxes, sales and use taxes, coal taxes, oil and gas taxes, and fuels taxes.

Property Taxes

Senate Bill No. 2297* defined distribution lines for purposes of taxation of generation, distribution, and transmission of electric power. The bill changed the taxation of rural electric cooperatives from a tax on gross receipts to a transmission line mile tax and a tax of \$1 per megawatt-hour for retail sales to consumers in this state. Cooperative electrical generating plants will remain subject to coal conversion facilities taxes. The taxes are in lieu of real or personal property taxes and an option is provided for investor-owned utilities to opt-in to the taxing system established by the bill. Revenue from the taxes are allocated among political subdivisions based on the location and tax rate for transmission lines and, for distribution companies, are allocated equally based on retail sales locations and the location and tax rate for distribution lines.

Senate Bill No. 2031 extended from 2011 to 2015 the deadline for completion of construction of a wind turbine electric generation unit with a generation capacity of 100 kilowatts or more to qualify for valuation at 1.5 percent of assessed value to determine taxable valuation of the property. This bill was introduced by the Legislative Council at the request of the Energy Development and Transmission Committee.

House Bill No. 1382 provided that all taxable oil or gas pipeline property must be assessed by the State Board of Equalization.

Senate Bill No. 2089 eliminated obsolete provisions relating to listing and assessment of severed coal and mineral interests.

Income Taxes

House Bill No. 1489 added soybean and canola crushing facility equipment costs to the corporate income tax credit available for biodiesel production facilities. The credit is 10 percent per year for five years of the taxpayer's direct costs to adapt or add equipment to produce crushed soybeans or canola.

Senate Bill No. 2033 extended the deadline from 2011 to 2015 for installation of a geothermal, solar, wind, or biomass energy device to qualify for the income tax credit equal to 3 percent per year for five years of the actual cost of acquisition and installation of the device. This bill was introduced by the Legislative Council at the recommendation of the Energy Development and Transmission Committee.

House Bill No. 1277 allowed the income tax credit for geothermal energy device installation to be claimed on the Form ND-1 income tax return.

Sales and Use Taxes

Senate Bill No. 2037 included gas recovered from oil wells for purposes of the sales tax exemption for materials used in the compressing, processing,

gathering, or refining of gas and required that, to be exempt, the property must be incorporated in expansion of a system used to compress, process, gather, or refine gas. This bill was introduced by the Legislative Council at the recommendation of the Energy Development and Transmission Committee.

Senate Bill No. 2032 extended the deadline from 2011 to 2015 for the exemption from sales and use taxes for materials used in construction or expansion of a wind-powered facility. This bill was introduced by the Legislative Council at the recommendation of the Energy Development and Transmission Committee.

Senate Bill No. 2035* removed the limitation that beneficiated coal must have been subject to severance taxes before being exempt from sales taxes. The bill also extended the sales and use tax exemption for power plant equipment to cover the equipment for an electrical generating plant that converts beneficiated coal into electrical power. This bill was introduced by the Legislative Council at the recommendation of the Energy Development and Transmission Committee.

Coal Taxes

Senate Bill No. 2297* revised taxation of rural electric cooperatives and cooperative electrical generating plants. The bill provided that cooperative electrical generating plants continue to be taxed as coal conversion facilities.

Senate Bill No. 2221 provided a credit against coal conversion facilities taxes for carbon dioxide capture from the emissions of the facility. A coal conversion facility that achieves a 20 percent capture of carbon dioxide emissions after 2009 is entitled to a 20 percent reduction in the state general fund's share of the coal conversion facilities tax. The facility is entitled to an additional reduction of 1 percent of the state general fund share of the tax for every additional two percentage points of the capture of carbon dioxide emissions, up to a maximum reduction of 50 percent of the state general fund share of the tax. The credit is available for 10 years from the date of first capture of carbon dioxide emissions.

House Bill No. 1015 provided that beginning with the 2011-13 biennium, the State Treasurer shall allocate funds provided by legislative appropriation to a coal-producing county to offset 50 percent of the loss of that county's share of coal severance tax revenue allocated to a non-coal-producing county because of the proximity of a tippie to the border of the coal-producing county. The bill required the State Treasurer to include in each biennial budget request the amount estimated to be necessary to fund the payment by the state.

Senate Bill No. 2377 made a technical correction of statutory language relating to the provision for coal severance tax allocation because of the proximity of a tippie of an active coal mining operation to the border of a county in which no coal is mined.

Senate Bill No. 2036 provided that a coal conversion facility's tax exemption for repowering

applies to a facility using beneficiated coal and that the exemption applies to electrical generating units, rather than the entire plant. This bill was introduced by the Legislative Council at the recommendation of the Energy Development and Transmission Committee.

Senate Bill No. 2035* provided a coal severance tax exemption for coal purchased for improvement through the process of coal beneficiation for use to produce steam used in agricultural commodity processing facilities in North Dakota or adjacent states or facilities owned by the state or a political subdivision. This bill was introduced by the Legislative Council at the recommendation of the Energy Development and Transmission Committee.

Oil and Gas Taxes

House Bill No. 1235 provided a contingent rate reduction in the oil extraction tax, which reduces the oil extraction tax rate for horizontal wells from 6.5 percent to 2 percent during the time the rate reduction is in effect. Existing law provided a complete oil extraction tax exemption that triggered into effect if the price of oil for five consecutive months remains below the trigger price. April 2009 would have been the fifth consecutive month below the trigger price but the average price for April rose to an amount exceeding the trigger price, which meant that the exemptions under existing law did not trigger into effect. Because the exemptions did not trigger into effect, the rate reduction provided by House Bill No. 1235 became effective May 1, 2009, and will remain in effect until the first day of the month following a month in which the average price of a barrel of crude oil exceeds \$70. The rate reduction applies to oil produced during the first 18 months after completion for a horizontal well and is limited to the first 75,000 barrels or the first \$4.5 million of gross value at the well of oil produced from the well. If the rate reduction is effective on the date of completion of a well, the rate reduction applies to production from that well for up to 18 months after completion, even if the price of oil rises to more than \$70. If the rate reduction is ineffective on the date of completion of a well, the rate reduction does not apply to production from that well at any time.

Senate Bill No. 2034 provided an oil extraction tax exemption for incremental production from a tertiary recovery project that uses carbon dioxide to enhance oil recovery. This bill was introduced by the Legislative Council at the recommendation of the Energy Development and Transmission Committee.

House Bill No. 1304, as amended by House Bill No. 1324, significantly increased allocation of oil and gas gross production taxes to political subdivisions and the oil and gas impact grant fund. From the tax equal to the first 1 percent of gross value at the well of oil production, a direct allocation of \$500,000 is created for a city in an oil-producing county which has a population of 7,500 or more and more than 2 percent of its employment engaged in the mining

industry. The allocation is increased to \$1 million if the city's employment in the mining industry exceeds 7.5 percent of its employment. Also from the tax equal to the first 1 percent of value of oil produced, the biennial allocation to the oil and gas impact grant fund is increased from \$6 million to \$8 million per biennium. The bill made several changes in allocations of oil and gas gross production tax revenue to political subdivisions. The bill increased from \$1 million to \$2 million the initial amount of tax revenue allocated 100 percent to the producing county. The bill removed the caps on tax revenue allocations to counties but provided that the amount exceeding \$18 million of annual revenue to a county is allocated 10 percent to the county and 90 percent to the state general fund. The bill required a county to levy at least 10 mills for county road and bridge, farm-to-market and federal-aid road, and county road purposes to receive any allocation of oil and gas gross production tax revenues. The bill restructured allocation of revenues within counties to hold school district allocations at approximately the level provided under prior law and established a county infrastructure fund for deposit of funds exceeding \$5,350,000 allocated to the county. Revenues allocated to a county infrastructure fund are allocated to the county and to cities in the same proportion as prior law, but the 35 percent share allocated to school districts under prior law is instead allocated to the board of county commissioners to provide grants to or for the benefit of townships or school districts. Grants are available on the basis of applications by townships for funding to offset oil and gas development impact to township roads or other infrastructure needs or applications by school districts for repair or replacement of school district vehicles necessitated by damage or deterioration attributable to travel on oil and gas development-impacted roads. For unorganized townships within the county, the board of county commissioners may expend an appropriate portion of county infrastructure fund revenues to offset oil and gas development impact to township roads or other infrastructure needs. The bill provided that within 60 days after the end of each fiscal year, the board of county commissioners of a county that has received oil and gas gross production tax revenue allocations must file a report with the Tax Commissioner showing the amount received by the county, the amount expended for each purpose to which the funds were devoted, the share of county property tax revenue expended for each of those purposes, and the amount of unexpended funds remaining at the end of the fiscal year. The report also must show the amount available in the county infrastructure fund, the amount allocated to each organized township or school district and the amount expended from that allocation by that township or school district, the amount expended on behalf of unorganized townships, and the amount in the county infrastructure fund which remained unexpended at the end of the fiscal year. The Tax Commissioner must

compile the information from the reports and provide a report to the interim Taxation Committee.

Senate Bill No. 2413* provided an oil and gas gross production tax exemption for gas burned at the well site to power an electrical generator that consumes at least 75 percent of the gas from the well.

House Bill No. 1164 provided for monthly, rather than quarterly, transfers of oil extraction tax revenues to the resources trust fund, common schools trust fund, foundation aid stabilization fund, and state general fund.

House Bill No. 1140 made technical corrections in the language relating to the share of oil and gas tax revenues deposited in the general fund and the permanent oil tax trust fund. The bill provided that interest earnings of the permanent oil tax trust fund must be credited to the general fund as they accrue, rather than at the end of each fiscal year.

Senate Bill No. 2051 increased from \$3 million to \$4 million per biennium the share of oil and gas tax revenues deposited in the oil and gas research fund.

House Bill No. 1126 made technical changes to provide that oil and gas research fund deposits are made before deposit of revenues in the general fund or permanent oil tax trust fund.

House Bill No. 1394 extended from 2007 to 2009 the provision providing for transfer of the first \$700,000 of the state's share of tax revenues from oil production within the Fort Berthold Reservation to the permanent oil tax trust fund. The bill also provided a statement of legislative intent that the amendment prevails over the repeal of NDCC Section 57-51.1-07.4 contained in **Senate Bill No. 2088**.

Fuels Taxes

Senate Bill No. 2228 added alternative fuels to the fuels for which motor vehicle fuel or special fuels dealers must pay the Tax Commissioner an inspection fee, for which monthly reports must be sent to the Tax Commissioner, and for which the Tax Commissioner may require a bond.

Governmental Entity

The governmental entity category is divided into Industrial Commission, Public Service Commission, Bank of North Dakota, and Department of Commerce.

Industrial Commission

Senate Bill No. 2129 combined the provisions relating to the biomass incentive and research program with the renewable energy program. The bill exempted the energy-related programs of the Renewable Energy Council from state procurement laws and the business incentive reporting requirement. The bill defined "advanced biofuel" for the purposes of the Renewable Energy Council law. The bill included on the Renewable Energy Council a member with a substantial interest in biofuel and sugar-based biofuel. The bill provided that any financial assistance provided by the Industrial Commission for a renewable energy project may not

be the sole support of the project and must be conditioned on the assurance that the applicant or a third party will support the project by either monetary or nonmonetary means.

Senate Bill No. 2014* transferred money from the biomass incentive and research fund into the renewable energy development fund. The bill appropriated \$1.5 million to the Industrial Commission from the lignite research fund for the purpose of contracting for an independent, nonmatching lignite marketing feasibility study to determine activities that will generate matching private industry investment and have the most potential of preserving existing lignite production and industry jobs or increasing the development of lignite. The same money may be used for nonmatching studies and activities in support of the Lignite Vision 21 program litigation to develop lignite resources, externality proceedings, and other activities that assist in the marketing of lignite-based electricity and byproducts. The bill appropriated money for a state facility lignite feasibility demonstration project which includes \$400,000 from the general fund to demonstrate the feasibility of using lignite at a state-owned facility equipped with coal-fired boilers generating at least 200,000 pounds of steam at 125 pounds per square inch upon the approval of the Lignite Research Council and the Industrial Commission.

Senate Bill No. 2376 allowed the North Dakota Transmission Authority to replenish a reserve fund for a portion of bonds issued by the authority.

House Bill No. 1383 authorized the North Dakota Pipeline Authority to participate in and provide funding for interconnection pipeline systems.

House Bill No. 1123 removed the requirement that the Industrial Commission approve leases of state-owned property.

House Bill No. 1067 exempted from the state classified service engineers and geologists employed by the director of mineral resources.

Public Service Commission

House Bill No. 1449 lowered the threshold for Public Service Commission siting jurisdiction for energy conversion facilities that generate electricity from 100 megawatts to 60 megawatts. In addition, the bill required the Public Service Commission to adopt rules governing the decommissioning of commercial wind energy conversion facilities and the rules must address present and future natural resource development. In addition, the bill required the facility owner or operator of a commercial wind energy facility to record the location of any portion of underground foundation not removed during decommissioning with the county recorder.

House Bill No. 1032 exempted from the energy conversion and transmission facility siting jurisdiction of the Public Service Commission construction conducted within the same footprint previously for which a certificate or permit was granted if the new activities do not affect any known exclusion or

avoidance area. If activities are expected to affect a known avoidance area, the utility must certify in writing to the commission that the activities will not affect any known exclusion area and that the utility will comply with all previous applicable conditions and protections. If the activities are expected to impact an avoidance area, the utility must notify the commission in writing and provide information on the specific avoidance area and reasons why impacts cannot be avoided and requires the utility to receive the commission's written approval. In addition, the bill exempted a transmission line that is less than one mile long from siting jurisdiction, a gas or liquid transmission line in a pipe with an outside diameter of four and one-half inches or less that will not be trenched and will not be plowed in with a power mechanism having a vertical knife or horizontally directionally drilled, and a pipeline that is less than one mile long from siting jurisdiction. This bill was introduced by the Legislative Council at the recommendation of the Energy Development and Transmission Committee.

Senate Bill No. 2137 required that application fees from public utilities be deposited in a special account and the money deposited is appropriated on a continuing basis to the Public Service Commission to pay expenses incurred in the processing of cases in which the application fees are required and the commission shall refund the portion of the fee which exceeds the expenses.

Senate Bill No. 2413* included a generation system that consumes wellhead gas that would otherwise be flared, vented, or wasted within the definition of renewable and recycled energy for energy credit tracking and trading by the Public Service Commission.

Bank of North Dakota

Senate Bill No. 2291 allowed a livestock operation that has reached the \$250,000 limit under the biofuels PACE fund to be eligible to receive another \$250,000 as an additional interest rate buydown for the purchase or installation of a biodigester system.

Department of Commerce

House Bill No. 1350 provided a \$5 million general fund appropriation to the Department of Commerce for the purpose of providing a grant for construction of a Great Plains Applied Energy Research Center on the Bismarck State College campus. This appropriation is contingent upon finding private sector matching funds at a rate of 3 to 1, a local property tax exemption, an exemption from future operational costs, and ownership based on contribution level.

Other Bills

The other bills category is divided into wind, property rights and royalties, oil and gas, and coal.

Wind

Senate Bill No. 2245 changed the time at which a wind option agreement, wind easement, or wind energy lease terminates due to inactivity from not any development within five years to if within five years a certificate of site compatibility or conditional use permit has not been issued, if required, and if within five years a transmission interconnection request is in process and not under suspension.

Property Rights and Royalties

Senate Bill No. 2139 vested in the owner of the overlying surface estate title to pore space and all strata underlying the surface of lands and waters and provided that conveyance of title to the surface of real property conveys the pore space and that pore space may not be severed from the title to the surface.

House Bill No. 1370 revised the procedure to succeed to ownership of and protect title to dormant minerals. The bill provided that failure to record a statement of claim will not cause a mineral interest to be extinguished if the owner of record files with the county recorder a statement of claim or files with the county recorder documentation that at least one of the activities deemed to be use of the mineral interest took place during the 20-year period immediately preceding the first publication of notice. The bill also provided that the owner or owners of the surface estate may maintain an action in district court in the county in which the minerals are located and obtain a judgment and perfect title in the owner or owners of the surface estate after satisfying the notice requirements of the termination of mineral interests chapter.

Senate Bill No. 2095 established permit, fee, and title requirements for the geologic storage of carbon dioxide.

House Bill No. 1071 added within the requirement that the interest on unpaid royalties is 18 percent per annum until paid the situation in which an operator fails to pay oil or gas royalties to an unleased mineral interest owner within 150 days from initial oil or gas production from the unleased mineral owner's mineral interests. In addition, the bill provided that this does not apply when a mineral owner cannot be located after reasonable inquiry by the operator. The bill provided that unleased mineral interests pooled after July 31, 2009, are entitled to a cost-free royalty interest equal to the acreage weighted average royalty interest of the leased tracts within the spacing unit or, at the operator's election, a cost-free royalty interest of 16 percent.

Senate Bill No. 2404 provided a lien for oil and gas owners to secure payment for the sale of oil and gas.

Senate Bill No. 2141 provided for damages to land surface caused by subsurface mineral extraction and related exploration for volcanic ash; precious metals; carbonates; and natural mineral salts of boron, bromine, calcium, fluorine, iodine, lithium, magnesium, phosphorus, potassium, sodium, thorium,

uranium, and sulfur; excluding coal, oil and gas, sand and gravel, and rocks crushed for sand and gravel.

Oil and Gas

Senate Bill No. 2413* provided that wells equipped with an electrical generator that consumes at least 75 percent of the gas from the well are exempt from the prohibition that gas may not be flared for longer than one year after the date of first production.

Coal

Senate Bill No. 2140 provided that for lands affected by coal mining activities before January 1, 1970, which are affected by remining, the operator's responsibility for successful revegetation extends for a period of five full years after the last year of augmented seeding, fertilizing, irrigation, and other work in order to ensure compliance with applicable revegetation standards.

Senate Bill No. 2014* revised the declaration of findings and public purpose regarding the lignite industry in the state.

Constitutional Measure

House Concurrent Resolution No. 3054 would establish a North Dakota legacy fund, provide for deposit of certain oil and gas revenues in the fund, and impose limitations on use of money in the fund. In particular, 30 percent of revenue from taxes on oil and gas production or extraction would transfer into the legacy fund and the Legislative Assembly may deposit additional funds. The principal and earnings in the legacy fund may not be expended until the fiscal year beginning in 2017 and an expenditure from the principal would require a two-thirds vote of the members elected to each house of the Legislative Assembly. A total cap of 15 percent of the principal would be imposed on expenditures each biennium. Interest accruing after the 2016 fiscal year would be deposited in the state general fund. This measure will be submitted to the qualified electors at the general election in 2010.

SUMMARY OF STUDIES, INCENTIVES, FUNDING, AND 2007 AND 2009 TAX REDUCTION TO PROMOTE ENERGY DEVELOPMENT

The following is a list of legislative changes during the last two legislative sessions and contained in the preceding bills which promoted energy development in this state. These changes are organized by the following categories of funds and funding, governmental entities and priorities, and taxes:

Funds and funding:

1. Expanded the biofuels PACE interest rate buydown (2007). Expanded for installation of a biodigester system and decreased funding (2009).

2. Increased funding to the lignite research fund (2007). Increased funding (2009).
3. Created the geophysical, geothermal, subsurface minerals, and coal exploration fund (2007).
4. Increased cap on the abandoned oil and gas well plugging and site reclamation fund (2007).
5. Created the geologic data preservation fund (2007).
6. Created the renewable energy fund (2007).
7. Created the biomass incentive and research fund (2007). Combined in renewable energy development fund (2009).
8. Provided funding for biomass research and education (2007).
9. Increased funding to the oil and gas research fund from the oil and gas gross production tax (2007). Increased funding (2009).
10. Created the biofuel blender pump incentive fund (2009).
11. Increased allocation of oil and gas production taxes to political subdivisions and oil and gas grant impact fund (2009).
12. Encouraged the State Board of Higher Education to create a biomass energy center (2007).
13. Funded the Great Plains Applied Energy Research Center (2009).
14. Provided for fracturing sand project with Division of Mineral Resources (2009).
15. Provided for coal bed methane drilling study with Industrial Commission (2009).

Governmental entities and priorities:

1. Created the Renewable Energy Council to recommend expenditures from the renewable energy development fund by the Industrial Commission (2007).
2. Provided for an energy policy commission (2007). Made permanent the Energy Policy Commission (2009).
3. Created the Energy Development and Transmission Committee (2007).
4. Made a priority to have carbon sequestration in this state (2007).
5. Created the North Dakota Pipeline Authority (2007). Expanded authority to include interconnection pipeline systems (2009).
6. Created the North Dakota Ethanol Council (2009).

Taxes:

1. Reduced property tax for wind generation facilities (2007). Extended this reduction (2009).
2. Extended sales tax exemption for materials for a wind-powered facility (2009).
3. Created a sales tax exemption for materials to process natural gas and oil (2007).
4. Reduced over time to eliminating the sales tax on natural gas and fuels used for heating (2007).

5. Extended a sales tax exemption for certain power plant equipment (2007). Extended exemption to beneficiated coal (2009).
6. Extended gross production tax exemption for shallow gas wells for the first 24 months of operation (2007).
7. Increased agriculture business investment tax credits and expanded these tax credits to include biofuels production facilities (2007).
8. Added soybean and canola crushing facility equipment costs to income tax credit for biodiesel production (2009).
9. Expanded income tax credits to install geothermal, solar, and wind devices to include biomass and made these tax credits tradable and transferable (2007). Extended this tax credit and placed the geothermal tax credit on the Form ND-1 income tax return (2009).
10. Reduced the oil extraction tax (2007). Created a new triggered reduction in the oil extraction tax for horizontal wells (2009).
11. Exemption from oil extraction tax for tertiary recovery (2009).
12. Allowed for agreements to collect and administer oil and gas taxes on the Fort Berthold Reservation (2007).
13. Created credit against coal conversion tax for capture of carbon dioxide (2009).
14. Created oil and gas gross production tax exemption for gas used to generate electricity at well site (2009).
15. Replaced rural electric cooperative gross receipts tax with a line mile tax and a megawatt/hour retail tax (2009).

SHALLOW GAS TAXATION

A shallow gas gross production tax exemption was created in 2003 by House Bill No. 1145. The legislative history reveals that the purpose of the exemption was to generate activity in the drilling of shallow gas wells, especially coal bed methane gas wells. The fiscal note on the bill stated that the overall fiscal impact was an expected reduction in gross production tax revenues totaling \$400,000 for the 2003-05 biennium.

The gross production tax on gas is an annually adjusted flat rate per 1,000 cubic feet on all nonexempt gas produced in the state. Before 1991 the tax was 5 percent of the gross value. The annual adjustments are made according to the average producer price index for gas fuels. Rates through June 30, 2010, are:

| Time Period | Tax Rate |
|------------------------------|----------|
| July 1, 2002 - June 30, 2003 | \$.0824 |
| July 1, 2003 - June 30, 2004 | \$.0615 |
| July 1, 2004 - June 30, 2005 | \$.1037 |
| July 1, 2005 - June 30, 2006 | \$.1215 |
| July 1, 2006 - June 30, 2007 | \$.1640 |
| July 1, 2007 - June 30, 2008 | \$.1428 |
| July 1, 2008 - June 30, 2009 | \$.1476 |
| July 1, 2009 - June 30, 2010 | \$.1831 |

Exempt from the tax is gas used on the lease for production purposes and the royalty interest in gas produced from a state, federal, or municipal holding and from an American Indian holding within the boundary of a reservation.

Shallow gas produced during the first 24 months of production from and after the first date of sales from a shallow gas zone after June 30, 2003, is exempt from gross production tax. Initially, this exemption was ineffective for gas wells completed or recompleted after June 30, 2007. However, the June 30, 2007, limitation was removed in 2007 by House Bill No. 1279. The legislative history reveals there was some concern with the fiscal note. The fiscal note stated that by continuing the 24-month exemption, revenues to the permanent oil tax trust fund are expected to decrease by \$1.1 million in the 2007-09 biennium. As for counties, most of the current shallow gas wells are located in a county that will reach the gross production gas cap so the county revenues will not be reduced by making the exemption permanent. However, new activity may occur in other counties and these counties would have to wait until the end of the 24-month exemption to receive any gross production tax revenue.

The legislative history reveals the 24-month exemption resulted in a sevenfold increase in the number of wells in production. Testimony indicated that the increased activity was a result of the tax exemption and the fiscal note was based on an assumption that the drilling that was encouraged by the current shallow gas would be in a single geological formation from one field in southwestern Bowman County. There was hope that the extension of the exemption would encourage companies to explore shallow gas in eastern North Dakota.

The North Dakota Geological Survey, Department of Mineral Resources, has been conducting shallow gas field screening across the state. The department should be able to provide information to the committee on research being conducted in eastern North Dakota and on drilling for shallow gas in this state.

REPORTS

The Legislative Council delegated to the Energy Development and Transmission Committee the responsibility to receive reports from a number of entities during the interim.

North Dakota Transmission Authority

Under NDCC Section 17-05-13, the North Dakota Transmission Authority is required to deliver a written report on its activities to the Legislative Council each biennium.

North Dakota Pipeline Authority

Under NDCC Section 54-17.7-13, the North Dakota Pipeline Authority is required to deliver a written report on its activities to the Legislative Council each biennium.

Energy Policy Commission

Under NDCC Section 17-07-01, the Energy Policy Commission is to develop and make changes to a comprehensive energy policy. The Energy Policy Commission is required to report biennially to the Legislative Council.

Industrial Commission

Two reports are required from the Industrial Commission. Senate Concurrent Resolution No. 4015 directs the Industrial Commission to study the economic impacts of proposed federal, regional, and state carbon cap and trade systems, including the Minnesota Next Generation Energy Act of 2007. The Industrial Commission is to report the findings and recommendations to the Legislative Council. In addition, as a part of 2009 Senate Bill No. 2095, which establishes permit, fee, and title requirements for the geologic storage of carbon dioxide, the Industrial Commission is required to file a report beginning December 2014 and every four consecutive years on the amount of money in the carbon dioxide storage facility trust fund and if fees being paid into it are sufficient to satisfy the fund's objectives under NDCC Section 38-22-15. Under the same section, storage operators of carbon dioxide must pay a fee based on the expense associated with long-term monitoring and management of a closed storage facility. The fees are placed in a carbon dioxide storage facility trust fund.

State Water Commission

In the bill that created the Energy Policy Commission, House Bill No. 1322 (2009), the State Water Commission is required to study and determine unit water use for each energy sector, including petroleum, ethanol, electrical generation, and biodiesel; identify water quality constraints for each energy sector; estimate projected water use in each energy sector based on growth projections provided by the Energy Policy Commission; and assess the quality and sources of water for energy development. The State Water Commission is required to cooperate with the Energy Policy Commission in conducting this study and must report to the Legislative Council before September 1, 2010.

Coal Conversion Facilities

As a result of Senate Bill No. 2221 (2009) and as codified under NDCC Section 57-60-02.1, a coal conversion facility that achieves a 20 percent capture of carbon dioxide emissions is entitled to a 20 percent reduction in the state general fund share of the coal conversion tax. In addition, the facility may receive an additional reduction of 1 percent for each two percentage points of capture of carbon dioxide emissions up to 50 percent and for 10 years. A coal conversion facility that receives a credit is required to report to the Legislative Council. The report must include an overview of the project; a status report on past, current, and captured carbon dioxide; any changes to the carbon dioxide capture system; and the status of federal law and any federal benefits to the project. The only project in this state at this time is at the Antelope Valley station near Beulah, North Dakota. The Antelope Valley station is part of an energy complex that includes the Great Plains Synfuels Plant and the Freedom Mine.

SUGGESTED STUDY APPROACH

Although the committee may study any particular area of energy, the difficult issue is for any particular area to relate comprehensively to the energy policy of this state. There are a number of entities in state government that carry out this state's energy policy, including the Public Service Commission, the Department of Commerce, the Industrial Commission, and the State Board of Higher Education. The Department of Commerce is the umbrella organization for the Energy Policy Commission, and the Industrial Commission is the umbrella agency for the North Dakota Transmission Authority; the North Dakota Pipeline Authority; and the Renewable Energy Council, which is chaired by the Commissioner of Commerce. Because energy policy is being administered and in some cases developed by other governmental entities, the committee may wish to receive testimony from these entities on energy policy before coordinating or changing the current policies.