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February 25, 2020

Commissioner Jodi A. Smith
North Dakota Department of Trust Lands
1707 North 9th Street
Bismarck, ND 58506-5523

RE: Formal Notification of Gas Royalty Repayment Obligations

Dear Commissioner Smith and North Dakota Land Board,
On behalf of our 715 members, that directly employ more than 32,000 employees in North Dakota and produce 98% of the oil and natural gas in our state, I am compelled to express the deep disappointment and frustration our industry experienced due to the recent action taken by the North Dakota Land Board (NDLB) and the North Dakota Department of Trust Lands (NDDTL) as set forth in the Department's February 11, 2020 letter (Letter).

We have five primary issues that are addressed in detail below:

1. Assuming the decision in *Newfield* stands, it would be reasonable and prudent to use May 1, 2017 as the point in time from which to recalculate deduct allowances going forward.
2. Like action taken by the NDLB in the case of *Sorum v. State of North Dakota* regarding lakebed minerals, any settlements paid should be held in escrow until all pending legal cases are finalized.
3. 90 days is too short of a period to require repayment without punitive interest and penalty. Calculating this issue will take substantial time; we request 180 days.
4. NDPC urges the NDLB to abide by state open meeting laws and follow its own established rules by providing an opportunity for public review of new Board policies at two NDLB meetings.
5. In its own guidance document, the NDDTL explains how to calculate royalties, and this clearly shows that deductions are allowed (see attachment A). In addition, a sample check stub from the NDDTL Revenue Compliance Division shows how to report royalties and how expenses are deducted (see Attachment B).

Since 2010, our calculations indicate that the oil and natural gas industry has paid nearly \$3 billion in royalties, lease bonuses, and rent to the various trust funds managed by the NDDTL. Of those funds, the Common Schools Trust Fund contributed an average of 10% of every North Dakota K-12 public school student's education costs. That represents \$367 million to public schools in the current biennium. As a result of investment by our industry in the production of oil and gas on state lands, our schools are better funded, our fund reserves exponentially enhanced, the property tax burden on our citizens has been reduced, and the future of education in our state is bright.

Unfortunately, your recent actions and subsequent letter ignores all we have done for education funding and even suggests that oil and gas operators intentionally underpaid royalties by falsely deducting costs from gas royalties. That assertion is simply not an accurate reflection of the

situation. From 1979 until the Department's notification to operators in early 2017 of a different interpretation, followed by the *Newfield* decision in 2019, the NDLB was aware of and had authorized the method of calculation used by operators to determine royalties. The NDLB was as equally unaware as any operator of any misinterpretation of the lease terms or the outcome of the ultimate court decision.

To put your new gas royalty enforcement into perspective, imagine you have completed your state taxes for four decades using a state-sanctioned tax deduction and a court ruling eliminates that previously accepted deduction. As a result, the North Dakota Tax Department sends you a notice saying, "Oops, we were wrong. Pay us now for every year you've ever used that deduction plus add prime plus four percent interest. And do it within 90 days or we will add another 18% interest and 12% penalty to your bill." You too would be outraged, just as my members were in reaction to your February 11 letter.

The Bakken is a world class resource and it will continue to generate billions of dollars for the State of North Dakota. To maximize that benefit, the State must take a holistic approach to its fiduciary responsibilities. The true economic value of the Bakken resides in the production of oil. Punitive actions, such as this, will decrease investment in the Bakken and in turn reduce the long-term benefits that NDDTL and the State of North Dakota receives.

Further, the recent actions taken by the NDLB provide an economic incentive to flare gas and reduce the capital available to build the infrastructure needed to decrease flaring. This unintended consequence is contrary to the regulatory work of the North Dakota Industrial Commission, public interests, and the effort and investment by the industry to reduce flaring. Our industry has already invested more than \$18 billion in natural gas infrastructure, and we are not done yet. Capturing and managing this growing gas resource is a challenge and a priority for every operator, but we need the State to do its part if we are to succeed.

Going forward, and specifically in response to the Letter, the North Dakota Petroleum Council (NDPC) has the following recommendations for consideration:

1. Operators have been advised by the NDDTL that it is seeking payments retroactive to the first date of production of state-held minerals, which could be as far back as 1979. A recalculation of forty years of royalty payments is simply impractical and unattainable. Companies have come and gone, many no longer exist, ownership interests have been sold over and over, wells have since been plugged and abandoned, and records simply no longer exist.

Further, and pursuant to ND Administrative Code Section 43-02-06-04, the State of North Dakota requires operators to keep records for six years, including royalty statement records. The Internal Revenue Service and the Bureau of Land Management require seven and six years, respectively. And, for comparison purposes, the limitations period for the United States to retroactively collect underpaid or disputed royalties is seven years. Even the IRS, perhaps the most aggressive of any agency, is typically limited to a three-year statute of limitations and six years for large understatements of income. The forty-year recalculation period required by the NDLB is clearly legally flawed and discriminatory.

The North Dakota Assistant Attorney General memo to NDDTL advising of how royalties should now be calculated was dated March 8, 2017. The letter sent by NDDTL to operators enclosing the Assistant Attorney General's memo was sent to operators on April 5, 2017 informing them that production on or after May 1, 2017 should be calculated using the new method. It would be reasonable and prudent then to use this date as the point in time from which to recalculate deduct allowances going forward, assuming the decision in *Newfield* stands.

2. Like action taken by the NDLB in the case of *Sorum v. State of North Dakota* regarding lakebed minerals, any settlements paid should be held in escrow until all pending legal cases are finalized.
3. The 90-day timeframe for operators to compile their records and submit payment without being subject to even more punitive interest and penalty rates is unrealistic. Perhaps some operators with only a couple state leases could comply, but this timeframe is not enough for operators with multiple leases and operations covering state owned minerals going back to May of 2017, let alone a longer timeframe. NDPC urges the NDLB to set an initial timeframe of 180 days but provide for additional time if requested by operators who have leases and operations of larger scale and/or longer lease periods. Gathering this data is not a simple process and will be time consuming and costly.
4. Whether unintended or not, repeated closed-door sessions on this issue sent the industry the signal that the NDLB does not care about industry's concerns nor is interested in understanding the complexity of the marketing components and gas capture regulations we deal with daily.

Further, the NDLB adopted a policy in 2019 that any new Board policy would be brought before the Board at two meetings to allow notice, review, and potential input by the general public. To hold the entire discussion on the gas royalty issue over the course of multiple, closed-door meetings seems problematic. These discussions involved general policy issues, not just litigation matters, and implementing new policy with no formal action or a public vote is inconsistent with NDLB policies and certainly not in keeping with open and transparent government standards.

NDPC urges the NDLB to follow its own established rules, abide by state open meeting laws, and provide an opportunity for public review at two meetings of the NDLB. This situation is complex, and each operator, large and small, has unique requirements in its midstream agreements that you need to hear before making a final decision.

If the NDLB wants to treat this as pending litigation, it needs to compel the Land Commissioner to retract the letter threatening punitive action if lessees don't conform to a decision the State apparently still considers to be pending.

5. The NDDTL advised in the "ND Oil and Gas Royalty Workbook," page 2 column P, the following: "The royalty calculation: **Gross Owners Share less gathering/transportation, processing, and other deductions. Do not use formulas.**" (Attachment A). This

document was pulled from archived versions of the NDDTL's website as preserved by the Internet Archive – more commonly known as “The Wayback Machine.” The document was posted as of June 2015, and it was not removed from the website until June 2018. In addition, a sample check stub clearly showing examples of deductions taken was also provided by the NDDTL Revenue Compliance Division (Attachment B). They were accessed at this link:

<https://web.archive.org/web/20161221075058/https://land.nd.gov/Docs/FinancialServices/Instructions.pdf>

In closing, this matter is just one of several litigation issues facing the NDDTL, the State of North Dakota, and the Industry. Reasonableness and common sense must prevail. The North Dakota Petroleum Council and its members stand ready to engage and find a mutually beneficial solutions going forward.

In the absence of a process whereby operators can work through their unique situations and find resolution, we are very concerned that operators, large and small, with decades of operations on state lands and compliance with the guidance provided by the NDDTL, will have no option other than to pursue additional litigation.

It is difficult to relay the pure frustration from my members and long-time North Dakota businesses. I also cannot stress enough the importance of your decision on this matter. At a time when leading national presidential contenders are threatening to put our fossil fuels industry out of business, activists are making access to capital for investment into the oil and natural gas industry exceedingly difficult, and oil prices are making the economics very challenging, this is a significant issue. The punitive retroactive actions of the NDLB will have lasting negative impacts.

There is a reasonable solution. We urge you to step-back, reconsider, and find it.

Sincerely,



Ron Ness
President, North Dakota Petroleum Council

cc: Governor Doug Burgum
Attorney General Wayne Stenehjem
Secretary of State Alvin Jaeger
State Treasurer Kelly Schmidt
Supt. of Public Instruction Kirsten Baesler

Enclosures