

CHAPTER 2 OIL AND GAS

Definitions. The following definitions apply to this chapter:

1. "Arm's length transaction" means a transaction between parties with adverse economic interests where each party to the transaction is in a position to distinguish its economic interest from that of the other party and does not mean a transaction made by a corporation or other entity with itself, or a parent, subsidiary, or interrelated corporation or entity, or between partners or co-joint venturers, or between corporations or other entities having interlocking directorships or close business relationships which may compromise their individual interests.
2. "Bonus" means the monetary consideration paid by a lessee for the execution of an oil and gas lease by the Board.
3. "Coal" means a dark-colored compact and earthy organic rock with less than forty percent inorganic components, based on dry material, formed by the accumulation and decomposition of plant material. The term includes consolidated lignitic coal, in both oxidized and nonoxidized forms, and leonardite, having less than eight thousand three hundred British thermal units per pound [453.59 grams], moist and mineral matter free, whether or not the material is enriched in radioactive materials.
4. "Coal mining operation" means any type of activity, the aim of which is to discover the presence of coal, or to remove the coal so discovered from their original position on or in the land by any means whatsoever.
5. "Commercial quantities" means whether (1) the well yields a profit exceeding operating costs over a reasonable period of time, and (2) a reasonably prudent operator would continue operating a well in the manner being operated under the facts and circumstances.
6. "Delay rental" means the annual minimum payment given to maintain a mineral lease in the absence of production in commercial quantities during the primary term.
7. "F.O.B." means freight on board.
8. "Gas" means all natural gas and all other gaseous or fluid hydrocarbons not defined as oil, but shall not include coal, lignite, oil shale, or similar hydrocarbons.
9. "Gas well" means a well producing gas or natural gas from a common source of gas supply as determined by the North Dakota Industrial Commission, other than from coalbed methane.
10. "Gross proceeds" means the sum of all consideration in whatever form or forms, paid for the gas attributable to the lease.

11. "Leased premises" means the land subject to a given oil and gas lease.
12. "Market value" means the price a willing buyer would pay a willing seller in an arm's length transaction in which the buyer is not compelled to buy or seller is not compelled to sell.
13. "Oil" means crude petroleum oil and other hydrocarbons regardless of gravity produced in liquid form and the liquid hydrocarbons known as distillate or condensate recovered or extracted from gas, other than gas produced in association with oil and commonly known as casinghead gas.
14. "Oil well" means a well capable of producing oil and which is not a gas well as defined herein.
15. "Payor" means either the lessee or an entity other than the lessee who assumes, or agrees to perform, any of the lessee's rights and responsibilities under a lease.
16. "Terminate," unless otherwise provided, has the same meaning as the word "cancel."
17. "Trusts" means permanent trusts and other funds managed or controlled by the Board.
18. "When run" means that point in the time when the production from a well is removed or sold from the leased premises and delivered to the purchaser or user of such production; for purposes of computing royalties, that point in time shall be considered to be 7:00 a.m. central standard time, on the day the production is delivered, to the purchaser or user regardless of the actual time delivered.

Lease nomination. The Department will accept an oil and gas lease nomination for a tract not already under lease as reflected in Department records and may accept a nomination for a tract under lease which will expire prior to the date of the lease sale. The first nomination received on a tract is considered an offer and determines the opening bid.

1. The Department will accept a nomination for an oil or gas lease either electronically through the Department's website or in writing. The nomination period for a lease shall be the period set by the Commissioner during which the Department will accept lease nominations. A nomination must be accompanied by a nonrefundable nomination fee, in an amount set by the Department, and the fee must be submitted to the Department prior to the published deadline for each nomination period.
2. A lease nomination must be limited to a maximum of one quarter section, unless otherwise authorized under subsection three, or by the Board.
3. A nomination for a tract containing a body of water may include up to a section of land if the tract cannot reasonably be subdivided by quarter section or half section. The tract acreage, including islands, may be offered and described as "more or less" and may be adjusted by the Board within each quarter section.

Advertisement for public auction. The Department shall publish notice of a lease auction in the official newspaper of the county where the nominated tract is located and in the Bismarck Tribune. The notice must be published once, ten days prior to the day of the auction. The advertisement must specify the date, time, and place of the auction, and how an interested person may obtain a list of the tracts to be auctioned. Should publication of any notice be inadvertently omitted by any newspaper or should the notice contain typographical errors, the Department may, in its discretion, proceed with the scheduled leasing if it appears that the omission or error is not prejudicial to the Department's interest.

Public auction. The Board may issue oil and gas leases by public auction. Public auctions may be hosted either live or online at the discretion of the Commissioner. Bidding is based on a bonus of not less than one dollar per acre, and an annual delay rental of not less than one dollar per acre per year based on the acreage shown in the records of the Department at the time the lease is issued.

1. The successful bidder at an online auction shall pay the bonus, the rental payments for the primary term as defined by the lease, the advertising fee, and any processing fees via Automated Clearing House (ACH) or wire transfer, by five p.m. central standard time, ten days after the date the auction closed. The Board shall not issue an oil and gas lease until receipt of the bonus, rental payments, and fees.
2. The successful bidder at a live auction shall pay the bonus, at least one year of rental payments, and the advertising fee via Automated Clearing House (ACH) or wire transfer, by five p.m. central standard time ten days after the date the auction closed. The Board shall not issue the oil and gas lease until receipt of the bonus, rental payments, and fees.

3. In the event no bids are received, the nominator shall be deemed the successful bidder and shall pay the bonus, at least one year of rental payments, the advertising fees, and any processing fee via cash, check, Automated Clearing House (ACH) or wire transfer, by five p.m. central standard time, ten days after the date the auction closed. The Board shall not issue the oil and gas lease until receipt of the bonus, rental payments, and fees.

Rejection of nomination and bids. The Commissioner may, in the best interests of the trusts, reject a nomination or a bid any time prior to the issuance of a lease.

Form and term of lease. A lease must be issued on a form approved by the Board. A lease must be made for a term of not less than five years and continue in effect under such term and for as long as oil or gas may be produced from the leased premises in commercial quantities or unless otherwise extended. A lease must provide for a bonus of not less than one dollar per acre and an annual delay rental of not less than one dollar per acre per year based on the acreage shown in the records of the Department at the time the lease is issued. A lease may contain such other terms and conditions as the Board deems appropriate.

Assignment, amendment, or extension. A lessee shall submit a written request to the Department for an assignment, amendment, or extension of a lease, or a portion of the leased premises, utilizing the form available on the Department's website. A request must include any documents requested by the Department. Lessee shall submit a fee, in an amount set by the Board, to the Department with the request.

1. Assignments. All lease obligations must be current at the time the assignment is approved. The lessee shall remain bound by the terms and conditions of the lease and the Board's rules until the assignment is approved by the Department. Upon approval of the assignment, the assignee shall be bound by all the terms and conditions of the lease and the Board's rules. Assignor shall provide the Department with a copy of the fully executed assignment within thirty days from the approval.
2. Extensions. If, at the expiration of the primary term, production of oil and/or gas has not been obtained in commercial quantities on the leased premises but drilling, testing, completion, recompletion, reworking, deepening, plugging back, or repairing operations are being conducted thereon in good faith, lessee may, on or before the expiration of the primary term, file a written application with the Department for a one hundred eighty day extension of this lease, such application to be accompanied by a payment of ten dollars per acre, and the Commissioner shall, in writing, extend this lease for a period of one hundred eighty days beyond the expiration of the primary term and as long as oil and/or gas is produced in commercial quantities; lessee may, as long as such drilling, testing, or completion operations are being conducted in good faith, make written application to the Commissioner, on or before the expiration of the initial extended period of one hundred eighty days for an additional extension of one hundred eighty days, such application to be accompanied by a payment of twenty dollars per acre, and the Commissioner shall, in writing, extend this lease for an additional one hundred eighty day period from and after the expiration of the initial extended period of one hundred eighty days, and as long as oil and/or gas is produced in commercial quantities; this lease must not be extended for more than a total of three hundred sixty days from and after the expiration of the primary term

unless production in commercial quantities has been obtained or unless extended by some other provision hereof.

3. Amendments. A lessee may request an amendment to a lease for a specific purpose. A request for an amendment must state the specific grounds for the request. Approval of a request is at the discretion of the Commissioner and the Department shall notify lessee in writing whether or not the request is approved.

Voluntary release. To request a voluntary release of a lease, a lessee shall submit a written request to the Department for the voluntary release of a lease, or portion of a leased premises, utilizing the form available on the Department's website and all other documents requested by the Department. Approval of a voluntary release is at the discretion of the Commissioner and the Department shall notify lessee in writing whether or not the voluntary release is approved. All lease obligations must be current at the time the voluntary release is approved. The lessee shall remain bound by the terms and conditions of the lease and the Board's rules until the voluntary release is approved by the Commissioner.

Royalties. If a sale of gas, carbon black, sulfur, or any other products produced or manufactured from gas produced and marketed from the leased premises, including liquid hydrocarbons recovered from such gas processed in a plant, does not constitute an arm's length transaction, the royalties due lessor shall be as follows:

1. On any gas produced and marketed (except as provided herein with respect to gas processed in a plant for the extraction of gasoline, liquid hydrocarbons or other products), the royalty, as determined by the Board, shall be based on the gross production or the market value thereof, at the option of the lessor, such value to be based on the highest market price paid for gas of comparable quality and quantity under comparable conditions of sale for the area where produced and when run, or the gross proceeds of sale, whichever is greater; provided that the maximum pressure base in measuring the gas under this lease contract shall not at any time exceed 14.73 pounds per square inch absolute, and the standard base temperature shall be sixty (60) degrees Fahrenheit, correction to be made for pressure according to Boyle's Law, and for specific gravity according to a test made by the Balance Method or by the most approved method of testing being used by the industry at the time of testing.
2. On any gas processed in a gasoline plant or other plant for the recovery of gasoline or other liquid hydrocarbons, the royalty, as determined by the Board, is based on the residue gas and the liquid hydrocarbons extracted or the market value thereof, at the option of the lessor. All royalties due herein shall be based on eighty percent or that percent accruing to lessee, whichever is greater, of the total plant production of residue gas attributable to gas produced from the leased premises, and on forty percent or that percent accruing to lessee, whichever is greater, of the total plant production of liquid hydrocarbons attributable to the gas produced from the leased premises; provided that if a third party or parties are processing gas through the same plant pursuant to arm's length transaction and one such transaction accounts for an annual average of ten percent or more, or all such transactions collectively account for an annual average of thirty percent or more of the gas being processed in such plant, the royalty shall be based on the gross proceeds

of sale that would accrue to lessee if the gas were processed under the terms of the most remunerative third party transaction for processing gas in such plant. Respective royalties on residue gas and on liquid hydrocarbons where the requirements for using third party transactions cannot be met shall be determined by:

- a. The highest market price paid for any gas (or liquid hydrocarbons) of comparable quality and quantity under comparable conditions of sale in the general area F.O.B. at the plant after processing;
 - b. The gross proceeds of sale for such residue gas (or the weighted average gross proceeds of sale for the respective grades of liquid hydrocarbons), F.O.B. at the plant after processing; or
 - c. The gross proceeds of sale paid to a third party processing gas through the plant, whichever is greater. Lessee shall furnish copies of any and all third party gas processing agreements pertaining to the plant upon lessor's request.
3. On carbon black, sulfur or any other products produced or manufactured from gas (excepting liquid hydrocarbons), whether said gas be "casinghead", "dry" or any other gas, by fractionating, burning or any other processing, is based on the gross production of such productions, or the market value thereof, at the option of lessor. Such market value is to be:
- a. The highest market price paid for each of the products of comparable quality and quantity under comparable conditions of sale in the general area during the same month in which such products are produced; or
 - b. The average gross proceeds of sale for each of the products for the same month in which such productions are produced, whichever is greater; provided that if a third party transaction is used to determine royalty in accordance with subsection two, the royalty due under this subsection shall be determined in accordance with such transaction.
4. Lessee agrees that all royalties accruing to lessor under this policy shall be without deduction for the cost of producing, gathering, storing, separating, treating, dehydrating, vapor recovery, compressing, processing, transporting, conditioning, removing impurities, depreciation, risk capital, and otherwise making the oil, gas and other products produced hereunder ready for sale or use.

Disputed title royalty escrow account. Any payor that proposes to withhold royalty payments based upon an ownership dispute shall establish an escrow deposit account and shall deposit the disputed payments into this account.

1. The account must be established at the Bank of North Dakota, or other state or national chartered insured financial institution approved by the Commissioner, with the Board as a party to the escrow agreement.

2. Prior to a final resolution of the dispute, a partial release of the disputed payments may be made upon written approval by the Commissioner and the payor. Upon approval, the disputed payments must be distributed back to the payor for proper distribution to the rightful owner.
3. Upon final resolution of the ownership dispute, and with consent of the Commissioner, the escrow agent shall be authorized to release all disputed payments held in the account to payor for proper distribution to the rightful owner. The Board is entitled to any interest income earned on the account attributable to North Dakota's ownership interest.
4. This section applies to matters where the amount of the disputed payments is twenty-five thousand dollars or more over a twelve month period. The Commissioner and the payor may agree that this section applies to leases executed prior to the effective date of this section.

Breach of lease.

1. Other than as provided in subsection seven, a lease may be cancelled for:
 - a. Nonpayment of any sum due under the lease;
 - b. Breach of any of the lease terms or conditions provided that such cancellation must not release lessee from liability for any sum due lessor or from any damages due to the breach; or
 - c. A violation of the Board's policies.
2. Before a lease is cancelled, the Department shall mail a notice of intention to cancel the lease specifying the reason for cancellation to the lessee by mail requiring a signed receipt at the address of the lessee as shown in the records of the Department. If the notice of intention to cancel is returned undeliverable or refused, the notice must be published in the official newspaper of the county in which the leased premises is located.
3. A lessee may file with the Commissioner a request for a waiver or a request to review the notice of intention to cancel the lease, which must include a statement of the specific grounds for the request. A request must be in writing and filed with the Commissioner within ten days after the date of notice of intention to cancel the lease is received or the date of publication. A request for a waiver or review is deemed filed when personally delivered or when received by the Department. The Board may waive any breach except a breach of lease terms required under North Dakota Century Code, or the Board may allow the lessee time to cure the breach. Any waiver must be limited to the particular breach waived and must not limit the Board's right to cancel the lease for any other breach.
4. If lessee has not remedied the default within thirty days after receipt of a notice of intention to cancel or the date of publication, the lease must be cancelled. The Department shall mail a notice of cancellation of the lease to the lessee by mail at the address of the lessee as shown in the records of the Department.

5. Cancellation of the lease does not release the lessee from liability for any sum due to the Board, other than as provided in subsection seven, or from any damages from a breach of the lease.
6. Upon cancellation of the lease, the Department shall file a Satisfaction of Lease with the register of deeds' office in the county where the leased premises is located.
7. A lease will automatically terminate for failure to pay the annual delay rental by the date due without further notice by the Department or opportunity for the lessee to remedy the default.

Reports of lessee – delinquency penalty. Royalty payment and reporting are due on forms prescribed by the Department as follows:

1. For gas:
 - a. Within one hundred twenty-three days of the last day of the month in which initial production occurs, royalty payment and reporting are due for the first, second, and third months of production.
 - b. Successive royalty payments and reporting are due within sixty-one days of the last day of the month in which production occurs.
2. For oil:
 - a. Within ninety-two days of the last day of the month in which initial production occurs, royalty payment and reporting are due for the first, second, and third months of production.
 - b. Successive royalty payments and reporting are due within thirty days of the last day of the month in which production occurs.
3. The royalty payment and reporting deadline may be extended by the Commissioner upon written request. An extension, if granted, only applies to future royalty payments and reporting.
4. Any sum, other than delay rentals, not paid when due is delinquent and is subject to a delinquency penalty of one percent of the sum for each thirty day period of delinquency or fraction of delinquency period, unless a waiver or Board review is requested under subsection six.
5. Unpaid royalties bear interest under North Dakota Century Code section 47-16-39.1.
6. A lessee shall have thirty days from the date of the receipt of a notice of a penalty and interest assessment to pay the penalty and interest, request a waiver or reduction, or to request Board review.

- a. A request for a waiver or reduction of the penalty or interest or a request for Board review must be in writing and provide the grounds for the request.
- b. The following factors may be considered when deciding to waive or reduce the penalty or interest: the reason for the late payment; the degree of control the payor had over the late payment; any unusual or mitigating circumstances involved; the loss of interest earnings to the trust involved; and any other relevant factors.
- c. The Commissioner may, for good cause, waive up to twenty-five thousand dollars of the penalty or reduce interest initially sought. A request for a waiver or reduction of penalty in excess of twenty-five thousand dollars must be presented to the Board, with the Commissioner's recommendation, for review and decision.
- d. A waiver or reduction of penalty and interest does not constitute a waiver of the right to seek the full amount of both penalty and interest if the initial claim for royalty payment is not paid. If a claim for unpaid royalties, penalties, and interest is settled and payment received, the amount of penalties and interest not collected is deemed waived.

Audit and examination.

1. The Department may audit and examine any records, including:
 - a. Books, accounts, and receipts; and
 - b. Contracts and other records pertaining to the production, transportation, sale, and marketing of the oil or gas or other products produced from the leased premises.
2. The Department shall serve by certified mail, a written request to payor specifying the documents requested. Payor shall have thirty days from the date of receipt of the request to provide the requested documents. Payor may request an extension of time to produce the documents. Any request must be in writing, specify the reason for the request, and be received by the Department within sixty days of receipt of the Department's request for documents. The Department may extend the time for production of documents. If the Department denies a request for an extension, the payor shall produce the information:
 - a. Fifteen days after receipt of a denial of the request for an the extension; or
 - b. Thirty days after the date of the original document request, whichever is later.
3. A payor who intends to withhold requested documents beyond thirty days after the date of receipt of the request shall provide a detailed explanation of the legal basis for withholding the documents. If no explanation is provided, the lease is subject to cancellation under the Breach of Lease policy.
4. After audit and examination of the records set forth in subsection one, the Department shall notify payor of the results, including the audit findings, the basis for that determination, and the date by which a response to the findings is due.

5. A payor shall have sixty days from the date of the receipt of the audit findings to comply, respond to the findings, or request Board review. A request for Board review must be made in writing and include a statement of the reasons for disagreement with the audit findings. If a payor fails to comply with the audit findings, respond to the findings, or request Board review within sixty days, the lease is subject to cancellation under the Breach of Lease policy.

Request for shut-in status for oil.

1. A lessee requesting shut-in status of an oil well, without cancelling the lease, shall submit a written request to the Department utilizing the form available on the Department's website. The request must contain the following information:
 - a. The name and well file number assigned by the North Dakota Department of Mineral Resources Oil and Gas Division;
 - b. The township, range, and section of the surface location of the well;
 - c. The Board's lease number for the subject lease, the date of the lease, the acreage covered by the lease, and the current lessee;
 - d. The name and address of the operator of the well;
 - e. The cumulative oil production and the number of days of production for the three months immediately preceding the request;
 - f. The written approval of the request from the operator;
 - g. The grounds for the request and the anticipated length of time the well will be shut-in; and
 - h. Any additional information requested by the Department.
2. An application fee, in an amount set by the Department, and the shut-in royalty payment must be submitted with the application. If the application is denied, the shut-in royalty payment will be refunded by the Department.
3. An application is deemed filed when the Department receives the application form, application fee, shut-in royalty payment, and any additional information requested by the Department.
4. Within fifteen days of receipt of an application, the Commissioner shall notify the applicant in writing, as follows:
 - a. The application is approved and the terms of the shut-in approval;
 - b. The application is denied;
 - c. An additional fifteen day period is necessary to consider the application; or
 - d. The application requires Board approval.

5. If an application is denied, a lessee may file with the Department a written request for Board review, specifying the grounds for the request.
6. A shut-in approval is effective for one year from the date of approval unless the Commissioner determines a shorter amount of time is appropriate.
7. The Commissioner may revoke a shut-in approval if it determines the action is in the best interests of the trusts. If a shut-in approval is revoked prior to its expiration, the Department will provide notice to the lessee by certified mail. Within sixty days from the date of receipt of the notice, the lessee shall re-establish production. If the lessee fails to re-establish production, the shut-in approval must be revoked and the lease is subject to cancellation under the Breach of Lease policy.