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ONE J

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NORTH DAKOTA



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I. Introduction

This Article summarizes and discusses important developments in North Dakota oil and gas law between August 1, 2018, and July 31, 2019. Part II of this Article will discuss common law developments in both state and federal courts in North Dakota and Part III will discuss the state's recent legislative and regulatory developments.

II. Judicial Developments

Johnson v. Statoil Oil & Gas LP

The Supreme Court of North Dakota held that Pugh clauses controlled over habendum and continuous drilling clauses when the Pugh clauses were an original part of the contract, and the remaining clauses were copied from forms.¹ Thus, the Pugh clause determined when the mineral leases terminated.²

Several oil and gas lessors ("Johnson") brought suit against oil and gas companies ("Statoil") claiming the Pugh clauses within the oil and gas leases controlled when the leases terminated after the primary term for units not producing oil.³ The units at issue included three producing units and five non-producing units.⁴ The Pugh clause stated:

Notwithstanding anything to the contrary, on expiration of the primary term of the lease, the lease shall terminate as to any part of the property not included within a well unit or units, as established by appropriate regulating authority, from which oil or gas is being produced in paying quantities. . . .⁵

Johnson argued the Pugh clauses controlled and that the leases for the five units that were not producing oil and gas in paying quantities should have terminated at the expiration of the three-year term.⁶ Statoil argued, and the lower court agreed, that the continuous drilling clause controlled the lease termination.⁷ The clause stated:

1. *Johnson v. Statoil Oil & Gas LP*, 2018 ND 227, 918 N.W.2d 58, 63.

2. *Id.*

3. *Id.* at 60-61.

4. *Id.* at 61.

5. *Id.*

6. *Id.* at 61.

7. *Id.*

If, at the expiration of the primary term of this lease, oil or gas is not being produced on the leased premises or on acreage pooled therewith but Lessee is then engaged in drilling or reworking operations thereon, then this lease shall continue in force so long as operations are being continuously prosecuted on the leased premises or on acreage pooled therewith, . . . If oil or gas shall be discovered and produced as a result of such operations at or after the expiration of the primary term of this lease, this lease shall continue in force so long as oil or gas is produced from the leased premises or on acreage pooled therewith.⁸

The lower court granted summary judgement in favor of Statoil. Johnson appealed and the Supreme Court found that the clauses could not be reconciled and determined that the Pugh clause controlled because it was original to the contract and not copied from a form.⁹ Thus, the only way leases could be extended beyond the primary term was if the land was “within a unit or units where there was oil and gas production in paying quantities.”¹⁰ The Court reversed the district court’s judgement and determined the leases for the five nonproducing units had terminated.¹¹

Dale Expl., LLC v. Hiepler

The Supreme Court of North Dakota determined that mineral deeds are enforceable against settlors individually and in their capacity as a settlor.¹² The court reversed the lower court’s award of damages in place of specific performance.¹³

The Appellees, the Hieplers, were ordered by the lower court to pay the appellants, Bill Seerup and Hurley Oil Properties (“Seerup and Hurley”) approximately \$20,000 after breaching a contract to convey 150 net mineral acres in Williams County.¹⁴

In 1997, the Hieplers created a family trust (“Trust”) and conveyed most of their mineral interest to the Trust.¹⁵ Orville and Florence Hiepler were

8. *Id.* at 60.

9. *Id.* at 63.

10. *Id.*

11. *Id.*

12. *Dale Expl., LLC v. Hiepler*, 2018 ND 271, 920 N.W.2d 750, 759, *reh'g denied* (Jan. 15, 2019).

13. *Id.*

14. *Id.* at 753–54

15. *Id.* at 753 (Orville G. Hiepler and Florence L. Hiepler Family Trust Dated January 9, 1997).

named as co-trustees, and the Trust allowed for the settlor to add property to the trust or remove property from the trust without notice or permission from the trustees.¹⁶ Ten years later, the Hieplers deeded the mineral acres to Bill Seerup without mention of the Trust.¹⁷ Seerup did not complete a title examination.¹⁸ Orville Hiepler only owned approximately 7 acres individually, with the Trust holding the remaining 143 acres.¹⁹ Seerup subsequently conveyed 135 mineral acres to Hurley.²⁰ Two years later, the Trust leased its mineral rights to another company; the same rights which had been conveyed to Seerup.²¹

Seerup sued for specific performance, and the lower court found for the Hieplers, denying the request for specific performance because damages were available.²² The lower court determined the Hieplers were only liable as trustees, and not as individuals.²³ Seerup and Hurly appealed.²⁴

On appeal, the Hieplers argued they were unaware of what property was individually owned when they conveyed the property.²⁵ The Supreme Court of North Dakota reasoned that both parties had constructive notice but further reasoned that Seerup would have been in the same position if he had performed a title examination because Orville Hiepler had the power to add or remove property from the Trust as the settlor.²⁶ The court found that the constructive notice did not bar Seerup from specific performance.²⁷ Further, the Hieplers would have known the land had already been conveyed when executing the second transfer, regardless if they were acting as trustee or in an individual capacity.²⁸

The court held that Orville Hiepler was liable as an individual and as the settlor.²⁹ Accordingly, the mineral deed was enforceable and specific

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.*

23. *Id.*

24. *Id.*

25. *Id.* at 756.

26. *Id.*

27. *Id.*

28. *Id.* at 758–59.

29. *Id.* at 759.

performance was the appropriate remedy.³⁰ A request for rehearing was denied in January 2019.³¹

Twin City Tech. LLC v. Williams Cty.

The Supreme Court of North Dakota found operative oil and gas leases invalid when a county failed to first advertise the leases.³² In February 2012, Williams County executed four oil and gas leases to the plaintiffs (“Twin City”) and received \$1.3 million in bonus payments.³³ Three years later, Twin City learned the County may not have owned all of the minerals subject to the lease and filed suit.³⁴ In November 2016, Twin City amended their complaint and sought declaratory relief and restitution for the bonus payments.³⁵ They claimed the leases were invalid because the County failed to publicly advertise the oil and gas leasing in accordance with the North Dakota Century Code before executing the leases.³⁶

Section 38-09-16 provides that “[be]fore leasing any lands or interest therein or any mineral rights reserved in any conveyance thereof, any county or other political subdivisions thereof shall advertise the same”³⁷ Section § 38-09-19 further provides:

No lease of public land for exploration or development of oil and gas production is valid unless advertised and let as hereinbefore provided, except:

1. Where the acreage or mineral rights owned by the state or its departments and agencies or political subdivisions is less than the minimum drilling unit under well spacing regulations, nonoperative oil and gas leases may be executed through private negotiation. . . .³⁸

The district court found the leases were operative, and thus not excluded from the advertising requirement.³⁹ The County then appealed to the

30. *Id.*

31. *Id.* at 750.

32. *Twin City Tech. LLC v. Williams Cty.*, 2019 ND 128, ¶ 14, 927 N.W.2d 467, 472-73.

33. *Id.* ¶ 2, 927 N.W.2d at 469.

34. *Id.*

35. *Id.* ¶¶3-4, 927 N.W. 2d at 469–70.

36. *Id.*

37. N.D. CENT. CODE ANN. § 38-09-16.

38. N.D. CENT. CODE ANN. § 38-09-19.

39. *Twin City Tech. LLC*, 2019 ND ¶ 9, 927 N.W.2d at 471.

Supreme Court, arguing that the leases were valid because each lease was for less than the minimum drilling unit and were individually nonoperative.⁴⁰ The County further contended the laches doctrine should apply because it was disadvantaged by Twin City seeking repayment two years later.⁴¹ The supreme court affirmed the district court and found the leases were expressly operative and thus invalid because they were not advertised.⁴² The court then found the laches question was a genuine issue of material fact and remanded the question to the lower court.⁴³

Newfield Expl. Co. v. State ex rel. N. Dakota Bd. of Univ. & Sch. Lands

The Supreme Court of North Dakota held that royalty payments calculated by gross proceeds may not be reduced to account for direct or indirect post-production costs.⁴⁴ The appellees (“Newfield”) held numerous leases with the appellants (“State”) for operating gas-producing wells in North Dakota.⁴⁵ The leases stated that the State’s royalties would be calculated based upon “gross production or the market value thereof, at the option of the lessor, such value to be based on gross proceeds of sale.”⁴⁶ After the State completed an audit of Newfield, it alleged Newfield was underpaying its gas royalties.⁴⁷ Newfield calculated the State’s royalty payments based on the gross proceeds it received from selling the gas.⁴⁸ However, the gross proceeds from the sale excluded the costs of making the gas marketable.⁴⁹ Newfield sought judgement declaring the royalty payments were properly calculated based on the gross proceeds received by the buyer.⁵⁰ The district court awarded summary judgement favoring Newfield’s interpretation of the royalty clause and the State appealed.⁵¹

The State argued, and the supreme court agreed, that the district court’s interpretation improperly required the State to share in the post-production

40. *Id.* ¶ 10-11, 927 N.W.2d at 471.

41. *Id.* ¶¶ 17-18, 927 N.W.2d at 473.

42. *Id.* ¶ 14, 927 N.W.2d at 472-73.

43. *Id.* ¶ 18, 927, N.W.2d at 473.

44. *Newfield Expl. Co. v. State ex rel. N. Dakota Bd. of Univ. & Sch. Lands*, 2019 ND 193, ¶ 11, 931 N.W.2d 478, 481.

45. *Id.* ¶¶ 2-3, 931 N.W.2d at 479..

46. *Id.* ¶ 7, 931 N.W.2d at 480.

47. *Id.* ¶ 2, 931 N.W.2d at 479.

48. *Id.*

49. *Id.*

50. *Id.* ¶ 4, 931 N.W.2d at 479.

51. *Id.*

costs of making the gas marketable.⁵² North Dakota law states that the term “gross proceeds” indicates that a lessor’s royalty is “calculated based on the total amount received for the product without deductions for making the product marketable.”⁵³ The court reasoned that it did not matter if Newfield or the purchaser made the gas marketable, those expenses were not to be shared with the State.⁵⁴ Thus, Newfield incorrectly calculated the royalties and the supreme court reversed the district court’s judgement.⁵⁵

III. Legislative and Regulatory Developments

A. Legislative Enactments

Senate Bill 2123

Senate Bill 2123, which was approved March 6, 2019, amended sections 38-08-04.4, 38-08-04.8, and 38-08-04.9 of the North Dakota Century Code.⁵⁶ The amendment authorized the North Dakota Industrial Commission to enter contractual agreements for the reclamation of saltwater handling facility sites and the reclamation of treating plant sites.⁵⁷ Further, the amendment authorized funds from the abandoned oils and gas well plugging and site reclamation fund to be used for reclamations of saltwater handling facilities and treating plants.⁵⁸ The commission may confiscate equipment used for the reclamations as compensation.⁵⁹ The act went into effect on August 1, 2019.⁶⁰

Senate Bill 2312

Senate Bill 2312, which was approved March 28, 2019, amended section 57-51.2-01 and section 57-51.2-02(5) regarding the allocation of revenue and taxes for oil and gas extraction taking place on reservations.⁶¹ As of August 1, 2019, tribes will receive eighty percent of all revenues and be subject to all applicable taxes attributable to oil and gas production on reservation land.⁶² The act further suspended section 54-53-23 and added new sections

52. *Id.*

53. *Id.* ¶ 8, 931 N.W.2d at 480.

54. *Id.* ¶ 11, 931 N.W.2d at 481.

55. *Id.* ¶ 12, 931 N.W.2d at 481.

56. S.B. 2123, 66th Leg. Assemb., Reg. Sess. (N.D. 2019).

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.*

61. S.B. 2312, 66th Leg. Assemb., Reg. Sess. (N.D. 2019).

62. *Id.*

to create a legislative management tribal taxation issue committee; to provide for application of all new oil and gas wells that begin drilling after June 30, 2019; to provide an expiration date of July 31, 2021, for section three; and to declare emergency measures.⁶³

Senate Bill 2212

Senate Bill 2212 was approved on April 10, 2019 and amended section 47-16-39 of the North Dakota Century Code and created procedures for the inspection of production and oil and gas royalty records when the royalty owner or assignee is the board of university and school lands.⁶⁴ The act also created a civil penalty of \$2,000 per day for failing to provide the Board of University and School Lands with the records.⁶⁵ The act went into effect on August 1, 2019.

Senate Bill 2344, "Pore Space" Bill

Senate Bill 2344 was signed into law on April 18, 2019. Known as the "Pore Space" Bill, the bill created section 47-31-09 of the North Dakota Century Code relating to the injection or migration of substances into pore space.⁶⁶ The bill further amended portions of Title 38 that related to pore space and oil and gas production.⁶⁷ As of August 1, 2019, oil and gas companies will not be required to compensate landowners for pore space used to hold oilfield wastewater.

B. Regulatory Changes

Industrial Commission Order No. 24665 (Amended)

On November 20, 2018, the North Dakota Industrial Commission amended its guidance policy regarding gas capture. The amendment included updates regarding right-of-way processes and allows operators to manage their own operations and gas capture plans in accordance with the commission's gas capture goals.⁶⁸

63. *Id.*

64. S.B. 2212, 66th Leg. Assemb., Reg. Sess. (N.D. 2019).

65. *Id.*

66. N.D. CENT. CODE § 47-31-09 (West 2019).

67. S.B. 2344, 66th Leg. Assemb., Reg. Sess. (2019); *see* N.D. CENT. CODE ANN. §§ 38-08-25, 38-11.1-01, & 38-11.1-03 (West 2019).

68. *See* Order No. 24665, N.D. Indus. Comm'n (as amended Nov. 20, 2018).

Industrial Commission Order No. 29398 (Amended)

On January 18, 2019, the North Dakota Industrial Commission amended the crude oil conditioning requirements. The amendment included policy guidance for safe crude oil transportation and marketability.⁶⁹

69. See Order No. 29398, N.D. Indus. Comm'n (as amended Jan. 18, 2019).