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NORTH DAKOTA LAND BOARD EXPLAINS SHUT-IN OIL POLICY – EXTENSION OF TIME TO RESPOND TO GAS ROYALTY AUDITS—DELAYED PAYMENTS OF STATE ROYALTIES

I. Shut-in Oil and Lease Extension Policies

On April 8, 2020, the North Dakota State Land Board met and discussed several issues relating to State oil and gas leases. While the State oil and gas lease form contains a shut-in gas clause, the shut-in clause does not apply to oil. In 1986, due to depressed oil prices, the Board adopted a shut-in oil policy allowing operators to shut-in oil wells beyond the temporary cessation clause. This policy remains in effect today and was recently codified as N.D. Admin. Rule 85-06-01-14. The Board anticipates many State oil wells will be shut-in due to depressed market conditions and the COVID-19 pandemic. It is anticipated the Board will freely grant shut-in requests, but the Board stresses that operators *must request, in writing*, authorization to shut-in any wells pursuant to the policy.

The Board also discussed extensions of existing leases. Section 8 of the State lease form requires that production must be obtained on or before the expiration of the primary term to extend the lease. This provision, however, does permit a lessee to seek an extension of 180 days by filing a written application with the Commissioner prior to the expiration of the primary term. A second extension may be considered, but in no event shall the lease be extended more than a total of 360 days. The Board requests that any requests for extension, in particular extensions required due to the COVID-19 pandemic, be directed to the Commissioner.

The Board's shut-in oil and lease extension forms and policies may be accessed at the Department of Trust Lands website link:

<https://www.land.nd.gov/surface-minerals-management/mineral-auctions/forms-and-policies>

II. Unpaid gas royalty claims – *Newfield v. State of North Dakota*

On February 11, 2020, the Department of Trust Lands (“Department”) sent a letter to all operators and lessees of State owned oil and gas leases requesting payment of “unpaid” gas royalties due the State. The letter requested operators to respond to the letter within 90 days. The basis for the Department’s letter was a recent decision by the North Dakota Supreme Court in *Newfield Exploration Company v. State of North Dakota*, 931 N.W.2d 478 (ND 2019). The *Newfield* case dealt with the interpretation of the State’s lease form relating to the interpretation of the “gross proceeds” clause as applied to arms-length gas purchase contracts. The Supreme Court held the “gross proceeds” clause in the Board’s lease form means “the royalty payments under the leases . . . may not be reduced by an amount that either directly or indirectly accounts for post-production costs incurred to make the gas marketable.” 931 N.W.2d at 481. On remand to the trial court, the District Court held that while the Supreme Court decision provided guidance as to the interpretation of “gross proceeds”, the Supreme Court did not decide *Newfield*’s defenses to the State’s claims. Those issues remain for trial. The case remains pending at District Court.

At its April 8, 2020 meeting, the Board extended the time for operators to respond to the Department’s letter of February 11, 2020 from 90 days to September 30, 2020. However, operators and lessees should continue to monitor the situation, as the Board could modify the response date depending upon COVID-19 pandemic issues or other issues.

III. Delayed Payments of State Royalties.

North Dakota administrative rule Section 85-06-01-12 provides the Commissioner may extend oil and gas royalty payments upon written request. The extension only applies to future royalties, not royalties currently or past due. The Commissioner has advised, if an extension is granted by the Department for future royalties, unpaid royalties will bear interest equal to the prime rate (as established by the Bank of North Dakota) plus 4%. Operators are encouraged to contact the Department if interested in applying for a delayed royalty payment extension.

If you have any questions regarding the updates above or how they may affect your operations, please contact Crowley Fleck PLLP. We are available to answer any questions or help our clients and neighbors in any way we can in these challenging times.

Shane Hanson
Oil and Gas Practice Group
(701) 223-6585
shanson@crowleyfleck.com

Craig Smith
Oil and Gas Practice Group
(701) 224-7521
csmith@crowleyfleck.com



To be added to the mailing list please contact Tiffani Swenson at tswenson@crowleyfleck.com

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