

Minutes of a Meeting of the Industrial Commission of North Dakota  
Held on April 21, 2020 beginning at 12:00 p.m.  
Pioneer Room - State Capitol

Present: Governor Doug Burgum, Chairman  
Attorney General Wayne Stenehjem  
Agriculture Commissioner Doug Goehring

Also Present: Lynn Helms, Department of Mineral Resources  
Some attendees are listed on the attendance sheet available in the Commission files  
This meeting was open through a call-in number so not all attendees are known  
Members of the Press

Governor Burgum called the Industrial Commission meeting to order at approximately 12:00 p.m. and the Commission took up Department of Mineral Resources business. Governor Burgum noted that this special meeting had been called to have a briefing on the extreme oil price volatility that has taken place and to discuss Industrial Commission options in response to this volatility.

**DEPARTMENT OF MINERAL RESOURCES (DMR)**

Mr. Lynn Helms, DMR Director, reported on the status of the current economic conditions of the oil industry. He noted that yesterday, the West Texas Intermediate Cushing Oklahoma price reached a negative \$40/barrel and closed the day at a negative \$37.63. The May contract expired, and focus has shifted to the June contract. This is a signal to the market that the storage in Cushing, Oklahoma is nearly full and in the month of May it will fill to capacity. Louisiana Light Sweet, LLS, was trading at -\$1.00 to -\$1.50 to West Texas Intermediate, also indicating no capacity on the Gulf Coast. The Brent price stayed at \$19-\$20/barrel, indicating there is refining capacity and some room for crude oil to arrive on the East Coast. However, today the Brent price has dropped by \$6.00 and the June contract for West Texas Intermediate is down \$8.00 to \$12.50. The markets for June are sending signals that if not full in May, storage will be full in June. Storage that is full in May will remain full in June.

Mr. Helms stated that the issue before the Commission is whether this one-day oil price volatility constitutes an emergency and what is the appropriate action that the Industrial Commission should take. Mr. Helms stated that he is in daily contact with Texas Railroad Commission and Oklahoma Corporation Commission representatives. Those states are slightly ahead of North Dakota in this process. Texas has held a hearing on a motion from their number one producer to prorate production. Feedback from the hearing was very much split on the appropriate course of action. As a result, this morning the Texas Attorney General was requested to look at the proration statute to determine if there are any issues that need to be resolved prior to the Railroad Commission taking any action. That law hasn't been used in nearly 50 years and may not be current with federal laws. Between today and May 5<sup>th</sup>, the Texas Attorney General is going to investigate that provision of the Texas law. The Railroad Commission staff has been directed to talk to the Province of Alberta which is the only place where proration has taken place in modern times to see what Texas would need to do to get prepared for proration. Texas could, in theory, prorate beginning June 1st, if they choose to move forward with that action.

In Oklahoma, an Administrative Law Judge, as part of a hearing, has made a determination that the production of crude oil and natural gas when the market price is less than production and post-production costs should be considered waste. The Judge's determination has been forwarded to the Oklahoma Corporation Commission. The Oklahoma Corporation Commission will be meeting to determine whether to issue a corresponding order this week. The Oil and Gas Division is trying to stay in synchronization with our sister states. Prorating will only matter if the states all work together. Mr. Helms will keep the Commission apprised of developments in other states.

Mr. Helms outlined the statutes in North Dakota Century Code that relate to the current situation as follows.

**38-08-06 – Authority to prorate production**

Mr. Helms provided the following history regarding proration. Case No. 2 of the Industrial Commission was issued on December 15, 1953 and was to prorate production. On that day, market capacity was 14,702 barrels/day. It is a different world today with capacity of 1.5 million barrels/day. The law was last used in October 1965 -- Commission Order 815. At that time, the market capacity was 81,000 barrels/day and the Mandan refinery was open. Mr. Helms noted that at that time, the goal was to set individual well/operator production so the capacity of the new Mandan refinery was fairly allocated amongst producers. Following that month of October 1965, it was clear to the Commission that the market had resolved itself and the Commission did not need to be making detailed decisions about well-by-well production. The Commission has not issued an order prorating production since 1965.

While Mr. Helms believes that the statute is current and would allow prorating production, he stated that he does not think this is the appropriate time to do so. In response to a question, Mr. Helms agreed that some producers have engaged in hedging and can produce profitably. In 1965, there was no crude market like the NYMEX or WTI Crude, no interstate pipelines, and there are a multitude of different contract structures today. There was no interstate natural gas pipeline system as well. Hedges didn't exist in those days. Several operators have hedged their oil through the end of the year. Proration would specifically interfere with those hedges and contracts. In addition, proration would create difficulties for companies that are going through reorganization. Proration would be a bridge too far at this point. However, it is important to keep in touch with Texas and watch what happens there.

The oil price and storage signal has been heard by the market. North Dakota crude oil production has been shut in and since yesterday crude oil production shut-ins have significantly increased in North Dakota. As of yesterday, the number of wells shut in reached 5,000 and the number of barrels of oil per day shut in has reached 295,000- 300,000 barrels a day. Approximately 40,000-60,000 barrels per day were shut in over the last 24 hours. As of March 1<sup>st</sup>, there were 16,118 active wells, meaning approximately a third of the wells in North Dakota have been shut in. The first wells to go were the marginal wells that produce a lot of water or are low-rate producers; then wells that were flaring a significant portion of their gas; and now we are starting to see wells that would be very economic in the \$20 range being shut-in.

Mr. Helms recommended the Commission not move forward with proration. However, he suggested that it be investigated to determine what proration would look like—similar to what Texas is doing. Attorney General Stenehjem agreed that this would be a good strategy so that the Commission can better understand the potential impacts of proration.

In response to a question, Mr. Helms affirmed that he has contacts in Alberta to utilize as resources on how proration works in Alberta. It was noted that most of the minerals in Alberta are owned by the government, which is very different from the situation in North Dakota.

Concerns were voiced about costs royalty owners could end up bearing—deductions in their royalty payments, etc. depending on the Commission's actions. Rather than proration, regulatory relief would be a good step in the right direction and should be investigated.

**38-08-02 – Preventing waste**

Mr. Helms highlighted 38-08-02.19 e, which defines waste as: “The production of oil or gas in excess of transportation or marketing facilities or in excess of reasonable market demand.” He noted that this is not easy to analyze or conclude and stated there appeared to be a brief nationwide market demand signal yesterday. However, that doesn't mean this threshold has been met in North Dakota. He urged proceeding

with caution and indicated it would be wise to see how this plays out in Oklahoma. The Administrative Law Judge recommended that the Oklahoma Corporation Commission make this determination and it would be good to see what kind of feedback the Oklahoma Commission receives from Oklahoma producers. They are being asked to determine if it is waste when the market value of crude oil or natural gas is less than the production and postproduction costs.

A question was raised regarding the amount of production that might have “take or pay” contracts and how this determination of waste would affect those contracts. Mr. Helms stated that crude oil postproduction costs vary, depending on the method of transportation and destination. If utilizing a pipeline to Cushing, it is estimated to be \$5-10/barrel. If utilizing a pipeline to the Gulf Coast, cost varies between \$5-8/barrel. If utilizing rail car for delivery to the East Coast, costs may be \$9-15/barrel. Transportation costs today are much more complex than they were in 1965.

DMR’s estimate, which varies by company, is that some companies have as much as 60% of their crude oil production (one operator for example has hedged 100,000 barrels/day) committed on a firm capacity contract on a pipeline. The majority of Dakota Access Pipeline capacity is firm contracts. It is estimated that 300,000 barrels/day of the contents of that pipeline is under firm contracts. If the Commission were to make a determination of waste and create a force majeure, it could potentially be \$1.5 million/day that Dakota Access is counting on and would not get. The Commission must be cautious in moving forward as their decision would create winners and losers. Infrastructure was built based on the promise of product being transported and revenues being received, and the Commission would be saying that product doesn’t need to be delivered. Since 2009-2010, North Dakota has been encouraging the building of infrastructure. As recently as last year, the Commission made a decision that firm capacity on gathering pipeline systems was not discrimination so that people could make these promises and get that capacity built.

In response to a question, Mr. Helms stated that analysts believe this situation will be resolved before the Brent market craters. However, if this 31% decline in refining runs extends into July, then Brent will crater too. The Commission should proceed slowly before taking action – look out a few weeks at a time. Does the June WTI contract follow the May contract and do Brent contracts start to show the same amount of distress? Refining capacity can turn down to 60% and then the refinery plants must idle. The plants are at 69.1% right now. If the Brent price falls or refining capacity nears 60%, this legal authority and option should be revisited.

Attorney General Stenehjem noted that the Commission’s authority under the law is broad as the definition of waste also includes production of oil or gas in excess of reasonable market demand. Mr. Helms agreed, noting that EIA data regarding refinery run rates should be monitored closely. If the rates drop another 10%, it is a signal that we are at or near market demand and all market options have begun to disappear. Currently, the Gulf Coast is no longer a preferred place for North Dakota oil. Cushing, Oklahoma is bad but better than the Gulf Coast and the Brent market is still ok. If that market declines, it will signal when the Commission should consider an emergency situation and consider making a determination on waste.

The consensus of the Commission was that caution is needed. The Commission has broad regulatory authority, and it is worthwhile to do analysis. The desire is to help, but not at the expense of a sector the Commission hasn’t considered. The suggestion was that Mr. Helms continue to look at these factors and keep the Commission up to date. Industry may do a better job of resolving the issues with creative solutions such as taking product off a pipeline in Illinois and putting it on a train to the Northeast markets. In addition, options for regulatory relief should also be researched to determine the best course of action.

Mr. Helms noted that last month, the Commission authorized the inactive and noncompleted well waivers, and industry has been taking advantage of that regulatory relief to idle wells. What that doesn’t allow is the

triggering of the thousands of cessation clauses that exists in their leases. Some are arguing that determining producing at “x” dollars a barrel is waste and creates a force majeure and allows the operator to force majeure that cessation of production clause. The North Dakota Supreme Court has been reluctant to agree with district courts on force majeure. Those claiming force majeure have been required to show evidence that they did everything possible to avoid a force majeure situation before it occurred. That is a high bar and so there is no guarantee the Commission declaring something as waste under 38-08-02 will actually create the kind of force majeure that people would be looking for.

It was suggested that it would be wise to hold a hearing in order to gather information from midstream, service industry, oil and gas companies, the public, etc. Both Texas and Oklahoma held hearings. If the Commission wants to pursue 38-08-02, it would be a good way to go.

It was determined that the Commission does not have an appetite for proration or intervening in markets unless absolutely needed. It was stated that the Commission has spent the last 3.5 years trying to incent midstream investment and a waste classification could be a disincentive to the midstream industry. There is a reluctance to have government involved in a way that would harm capital formation in North Dakota. It was indicated that holding a hearing would be useful to fully understand the intended consequences and unintended consequences and receive input on the things that could be done to provide assistance for the oil industry during these economic conditions.

#### **38-08-11 – Declare an emergency**

Mr. Helms reported that his understanding of 38-08-11, is that the Commission could act on the statutes previously discussed at any time. While it is a good tool to have in the toolbox, he doesn't believe that what occurred yesterday constitutes an emergency.

Attorney General Stenehjem agreed that the Commission does have that authority and it is quite broad. The Commission can act without notice or hearing. It is effective for 40 days and should be used with extreme caution.

Mr. Helms reported that the Department of Mineral Resources has been working with the Interstate Oil and Gas Compact Commission (IOGCC) to hold an event in mid-May for a multi-state discussion of these topics. The Department of Energy and other federal agencies will be invited. Examples of topics may include impacts on national security, the strategic petroleum reserve, programs that states and/or the federal government could implement to help the oil and gas industry recover. Perhaps a Bakken Smart Re-start.

One of the ideas that the Department of Energy has talked to IOGCC and the states about is how could some of the stimulus money be used to keep the oil field service industry viable during the next few months. One way would be by employing the industry to address the abandoned/orphan well situation. This would involve collaboration with other states and move the nation forward in terms of the long-term environmental situation that continues to develop—particularly the State of Pennsylvania, Oklahoma, and Texas. North Dakota also has a growing concern in this area.

Mr. Helms stated another idea relates to the 5,000 wells that have been idled. There will be costs to turn the idled wells back on. A significant number of these wells are going to require a workover rig and require repairs to pumps or rods. North Dakota has never had a situation where high producing wells were shut in or shutdown and the wells have a lot of pressure at the well head. There is a lot of mechanical work that must take place to make sure that the wells are safely brought back into production. Average cost estimates are between \$25,000-\$50,000 per well to put it back into production. At a 5,000 well count, the impact could be \$100-\$250 million to restore production once the markets have settled.

Mr. Helms stated that opportunities should be explored through stimulus funds, the Bank of North Dakota, and other entities to assist in keeping a viable oil service industry in North Dakota. It is going to be a monumental effort to restart one-third of the oil field. He strongly recommended North Dakota join in this effort through the IOGCC states to secure stimulus funds for maintaining a viable oil field service industry and funding to assist with putting wells back on production. He indicated that the Commission should consider at some point low or no interest loans to help to get the wells back on production because operators are going to be undercapitalized when that time comes.

Governor Burgum stated that consideration should be given to providing funds to pay the \$25,000 needed per well to get oil production back online. If you look at the oil tax revenue that the State depends on, spending money on kickstarting oil production would be the fastest way to improve the State's economic health. If the State can use federal stimulus funds for this purpose, then that kind of investment would have a huge ROI versus just about any other thing that the State spends dollars on in terms of speeding up the State's recovery. He indicated his support of implementing an effort that explores options for innovation versus regulation; getting wells back online and having the Commerce Department, Bank of North Dakota and others working with the Department of Mineral Resources to assemble ideas and proposals. He noted that there is a possibility that the federal stimulus money could be used for this purpose—it is not clear yet because full guidance on how the State federal stimulus money can be used is not available but he believes the reduction in oil demand is COVID related and if there is a broad definition then the State should be able to spend the stimulus dollars to get the economy going. While waiting to get that clarification, we should proceed with developing ideas to reduce the costs of production in North Dakota. The goal is to have North Dakota oil production back online first. If production costs can be reduced here through regulatory relief and incentives are available, then operators who are going to have limited capital will bring wells online in North Dakota.

Mr. Helms noted the Legislature would be back in session early next year and that concepts should be developed to be presented to the Legislature regarding the gross production tax and oil extraction tax such as some type of tax holiday for putting idled wells back on production. He indicated with oil at \$60, two weeks of production results in extraction taxes of \$100 million. A month of production would result in extraction taxes that would address the high end of the estimated costs for bringing the idled wells back online. This would have to be approached on a company by company and well by well basis, but it is something that should be discussed and considered in proposing concepts to the Legislature.

Governor Burgum stated it is something to be pursued, but because of the current situation and the tools the State may have using the federal stimulus dollars that action should move forward now. He also noted that this Commission had previously approved \$300 million for agriculture disaster loan funds. This is an energy sector disaster and consideration should be given to developing a Bank of North Dakota program that might parallel the agriculture disaster program. He suggested that this be considered by the Department of Mineral Resources working with the Bank of North Dakota and the Department of Commerce. If the industry starts to come back online this summer and we have 5,000 wells shuttered, one of the most important things the State could do is get those wells going again.

Mr. Helms stated that he is also hopeful that wells will be coming back on production before the beginning of next year.

Commissioner Goehring stated that he is supportive of finding out how much of the federal stimulus money can be used to offset some of the costs. He indicated that he liked the idea of developing a Bank of North Dakota program that would make some lower interest funds available. In regard to bringing wells back online, he comes from an industry where you can look at relief but you never make anybody completely whole. He expressed his support for the operators having some "skin in the game." If the State is going to propose something, he would support a percentage of assistance – interest relief or a percentage of

assistance. He agreed that the State will benefit from the wells being brought online and the industry would benefit too. He stated that there are some very reasonable approaches the State can take to really help stimulate activity as it is warranted.

Mr. Helms summarized the following action items.

- Stay in contact with Alberta, Texas, and Oklahoma regarding proration, and investigate the pros and cons should that become necessary.
- Hold a hearing to talk about what constitutes waste under 38-08-02 19e and get feedback from the industry and public. Create a record that the Commission could use in determining waste and other options the Commission should consider in responding to this situation.
- Pursue opportunities through IOGCC and discuss what federal funds can be made available to maintain North Dakota's oil field service industry such as dealing with abandoned wells and to also restart the idle oil and gas industry.

In response to a question, Mr. Helms noted that Pennsylvania currently estimates that they have 100,000 abandoned or orphaned wells that they know the location of and probably additional ones that were drilled before regulation in Pennsylvania that they don't even know existed. Texas has nearly 10,000 and Alberta has approximately 4,000 orphaned and 90,000 inactive wells. North Dakota currently has zero orphan wells. but at the present time has approximately 800 wells in abandoned well status. This means the well has not produced in paying quantities for over one year and in many cases the operator is under-capitalized, and the bonding isn't sufficient to cover the costs of plugging the well. He commented on some locations where the Oil and Gas Division anticipates wells moving to the orphan well status in the near future. North Dakota's needs, however, regarding orphan wells are much smaller than in the other states. This is an opportunity we should be pursuing to assure that the oil service industry remains viable in North Dakota.

Governor Burgum and Mr. Helms commented on the global and national security implications, importance of having a strong oil industry in the United States, and the global forces that are working to destroy that industry. It is important that the Commission be prepared to act if the current crisis becomes an emergency. Mr. Helms stated that by taking these steps the Commission will have the information needed to make decisions regarding the oil industry in North Dakota.

It was noted that the Commission received a letter from North Dakota Ethanol Producers. At its next regular meeting, the Commission asked that the Bank of North Dakota discuss opportunities to assist the ethanol industry. Commissioner Goehring noted that the ethanol industry was left out of COVID emergency funding that came from the United States Department of Agriculture.

Mr. Helms stated that the State of North Dakota is looking at filing an amicus brief in the Dakota Access Pipeline litigation. He may need to make a declaration or documentation and wanted to make the Industrial Commission aware of his actions. Attorney General Stenehjem indicated that this should be put on a future Industrial Commission meeting agenda.

With no further Industrial Commission business, Governor Burgum adjourned the meeting at 1:07 p.m.

North Dakota Industrial Commission



Karlene Fine, Executive Director and Secretary