



Third Meeting
2012 Interim
September 26, 2012

Room 413
State Capitol
Pierre, SD

Wednesday September 26, 2012

The third meeting of the 2012 Interim Oil and Gas Study Committee was called to order by **Senator Roger Solum, Chair**, at 8:15 A.M.

The meeting was held with the following members present: Representative Roger Solum, Chair; Senator Tom Nelson, Vice Chair; Senators Ryan Maher, Larry Rhoden, and Billie Sutton; and Representatives H. Paul Dennert, Spencer Hawley, Charles Hoffman, Melissa Magstadt, Betty Olson, and Tona Rozum. Senators Bruce Rempelberg, Tim Rave, and Craig Tieszen and Representative Dean Schrempp were excused.

Staff members present included: Reuben D. Bezpaletz, Chief Analyst for Research and Legal Services, Amanda Reiss, Legislative Attorney, Fred Baatz, Principal Research Analyst and Cindy Tryon, Legislative Secretary.

(NOTE: For purpose of continuity, the following minutes are not necessarily in chronological order. Also, all referenced documents distributed at the meeting are attached to the original minutes on file in the Legislative Research Council.)

Approval of Minutes

SENATOR RHODEN MOVED, SECONDED BY REPRESENTATIVE MAGSTADT TO APPROVE THE MINUTES OF THE JULY 16-17 COMMITTEE MEETING. The motion passed unanimously by a voice vote.

Overview of Visit to North Dakota Oil Fields

Amanda Reiss, Legislative Attorney, and Fred Baatz, Principal Research Analyst, gave a PowerPoint presentation on the committee's trip to the North Dakota oil fields on August 29 – 30, 2012 (**documents 1 & 2**).

The Oil and Gas Study Committee met at the Kelly Inn in Bismarck on August 28, 2012. That evening they received a briefing from the ND Petroleum Council and the ND Department of Minerals. North Dakota requires a \$50,000 well bond before drilling begins. Before the well bond is released, the well site must be returned to the same state it was in before drilling. This includes a return of natural vegetation. North Dakota also requires certain cement casing standards and plugging of the wells to be applied uniformly to protect the aquifers. Another North Dakota requirement is that the mineral

leaseholder gives the surface owner a seven day notice before entering the land for exploration or drilling.

Early the next morning, the group boarded a bus which took them, along with several North Dakota legislators, to the oil fields near Tioga, ND. They visited Hess headquarters, rail facility, and natural gas plant.

Then the committee travelled to the Williston area where they visited a walking drill site. Each mining company has its own mixture they use for fracking fluid which includes special sand and clay imported for use in the fracking process. The ingredients for the fracking fluid must be listed on the FracFocus website. This sand and clay may be an opportunity for South Dakota to ship product to North Dakota. There may also be economic opportunities with infrastructure development, constructing homes, equipment repair and rehabilitation, and much more.

The committee spent the evening at the Nabors Crew Camp near Williston. In Williston they heard from local elected officials, administrators, and other officials about challenges they are facing and how they are working to meet those challenges. They need help recruiting professionals for local businesses, hospitals, schools, etc. They also need more educational programs to prepare North Dakota youth for working in the oil industry. The people from that area are quite optimistic about their future.

Representative Spencer Hawley commented on that fact that housing seems to drive everything in the oil field area. Part of any salary/employment package has to be housing because it is so difficult for anyone wanting to work in any type of business in that area to find living accommodations.

Senator Larry Rhoden added that there is huge potential for spinoff industries that could be located in South Dakota. Representative Betty Olson shared samples of sand and ceramic beads that are imported to North Dakota. The committee agreed that South Dakota needs to do some investigating to see if we would have the ability to provide some of the sand and clay required in the fracking process.

Representative H. Paul Dennert said that it takes over 2,000 semi loads of materials to drill one well which explains the huge increase in traffic in North Dakota.

Chair Solum said that North Dakota wants South Dakota to be engaged in what is going on in the oil fields. They need support businesses to assist in housing construction, infrastructure construction, and other business activities. He said that South Dakota should be looking for every opportunity to capitalize on North Dakota's oil boom.

Executive Branch Briefing

Nathan Sanderson, Policy Advisor to the Governor, presented a copy of the Summary of Findings of the South Dakota Oil & Gas Development/Preparedness Executive Branch Work Groups (**document #3**), to the committee. Mr. Sanderson led the development committee while Jason Glodt, Policy Advisor to the Governor, led the preparedness committee. A copy of the document is available on the LRC website and the Department of Environment and Natural Resources (DENR) website.

Mr. Sanderson first introduced **Derric Illes, State Geologist, DENR**. Mr. Illes presented the information found on pages 9-21 of the Summary of Findings. He said that mining companies just recently figured out how to get the oil out of the Bakken basin in an economical way and that is why the oil boom is happening in North Dakota right now. The new technology gives oil drillers the ability to drill long horizontal laterals and use hydraulic fracturing. He said that there is an on-line interactive map available at sddenr.net/sdoil/oilgas_app.html which is being continuously updated with information on any type of wells drilled in South Dakota.

Mike Lees, DENR, then presented pages 22-31 of the Summary of Findings - South Dakota's potential for oil development. South Dakota's oil and gas production right now is steady and predicted to remain at the same level. They do not anticipate any large oil well developments outside the Red River formation in South Dakota. However, the Red River formation will continue to be explored and developed. Any large expansion in South Dakota would have to come from new exploration and discoveries.

The Summary of Findings includes different scenarios on what could happen in South Dakota due to oil and gas exploration. The scenarios are based on analysis and are "best guess" scenarios.

Mike Houdyshell, Director of Property Tax, Department of Revenue, explained pages 32-34 of the Summary of Findings. South Dakota has an energy mineral severance tax rate of 4.5 % of the taxable value of the mineral less any royalties paid to the government. The state also has a conservation tax of .24% on the taxable value of severed energy minerals. This tax was created in 1983 and the money funds the DENR oil and gas division. The severance tax averages around \$5 million per year and the conservation tax averages about \$280,000 per year.

Dave Wiest, Deputy Secretary, Department of Revenue, talked about the sales and use tax in regard to oil and gas exploration. South Dakota has a broad sales and use tax and does apply tax to some services relating to oil exploration and development. The estimate for sales and use tax from the oil industry is about \$1.1 million dollars per year. South Dakota use tax applies to machinery brought into the state that was not taxed in another state.

In studies of sales tax incentives in other states, such as Wyoming and Montana, it was determined that the incentive tax isn't beneficial when it comes to oil and gas exploration and drilling. Most tax experts agree that what drives the oil exploration is the location of the geological formation not tax incentives.

Mr. Sanderson then went through pages 35 – 37 of the Summary of Findings which include actions addressing surface owner issues. He also talked about the site visit to Harding County.

Mr. Sanderson continued by going through pages 46 - 54 which include a review of oil and gas statutes from several states including South Dakota. The research demonstrates that South Dakota is in line with what several other states are doing in

this area. However, there are some things other states do statutorily at which we might want to study further.

Bob Townsend, DENR, presented pages 55-67 of the Summary Findings which cover environmental protections regarding the minerals and mining program. He said there are two kinds of bonds for the oil industry – plugging and performance bonds and surface restoration bonds. Several other states have recently updated their bonding process and bond amounts. The average bond can cost anywhere from \$2000 up to \$25,000 in other states.

Mr. Illes talked to the committee about the core and cuttings repository. Statewide, there are approximately 550 drill holes for which the Geological Survey Program has cores and approximately 1920 holes for which the Geological Survey Program has cuttings.

Jason Glodt, Policy Advisor to the Governor, discussed the preparedness aspect of the Summary of Findings. He said that their research showed that what is occurring in North Dakota, as far as the oil boom, is much larger than what will likely occur in South Dakota. He said that the work group focused only on the northwestern area of South Dakota.

Joel Jundt, Director of Planning and Engineering, Department of Transportation (DOT), covered pages 76-78 of the Summary of Findings. He said that the biggest change is in traffic volumes. Traffic on US Highway 85 increased rather significantly from Belle Fourche north to the border. It has almost double since 2008. However, the DOT believes that the existing highway structure can adequately handle that increased level of traffic. The DOT is in the process of reviewing what may be done in regard to safety, such as adding turning/passing lanes specifically. As far as surface condition, Highway 85 is one of the state's better highway sections as it is in good or excellent condition. He added that about 22 miles of that highway near the community of Buffalo is due to be resurfaced in 2015.

Mr. Glodt continued reporting on concerns created by the possibility of an oil boom. He said that there is not a lot of housing available in the northwest region of the state and that any amount of development would put stress on housing. He added that emergency services are already strained, that there are not a lot of ambulance service providers and the existing ambulances are manned by volunteers. Those ambulance providers already are receiving an increase in calls. Fire departments would also be stressed with further development, as would healthcare facilities. There are no hospitals and only eleven medical clinics in that area.

Infrastructure concerns include water systems that would be impacted by any development. However, the electrical systems are in pretty good shape in that area and are positioned to accommodate growth. Several municipalities are currently working on zoning issues to prepare for any development.

In regard to law enforcement, increased crime levels in North Dakota may be attributable to population growth. There is already some spillover into South Dakota from the oil boom in North Dakota, especially with the South Dakota Highway Patrol. At

this time, there are only 3 troopers assigned to that area of the state. There has been an increase in accidents for that region.

There has also been an increase in activity in regard to the motor carrier division of the Highway Patrol. Since January 1, 2012, there have been 94 violations addressed. These violations mostly include log book and equipment violations.

The South Dakota Department of Criminal Investigation (DCI) has also experienced an increase in reported crime in that area.

As far as the education system in the northwest corner of the state, the school districts are prepared for growth as far as brick and mortar. They would need more teachers and staff to meet the needs of a growing population.

South Dakota has a lot of opportunity because of the growth and development in the surrounding states. South Dakota is already experiencing some economic development because of the oil booms in surrounding states. The study conducted by the Governor's Office shows that South Dakota should capitalize on those types of opportunities rather than thinking there will be a lot of oil and gas drilling here.

In response to questions, Mr. Jundt, DOT, said they are looking at adding passing lanes and turning lanes on Highway 85 to help the traffic flow. Mr. Glodt said that they are also looking at adding weigh scale stations to the area which could help control illegal trucks traveling through South Dakota to the oil fields in North Dakota. In order to do that, they first need to increase manpower in that area.

In response to questions about sales and use tax, Mr. Wiest said that North Dakota's sales and use tax rate is 5%, South Dakota's is 4% and Montana does not have a sales and use tax. Use tax applies to any equipment or products used in South Dakota if no sales or use tax has previously been paid. Equipment more than seven years old is no longer subject to the use tax.

In response to questions about the SD Office of Geology, Mr. Illes said that the core samples are kept in Vermillion at the geological offices and that people do come and look at the samples. They are currently updating the internet site regarding the samples to make it much easier for individuals and businesses to acquire that information. He said that there have been some previous discussions about moving the offices to the School of Mines in Rapid City but USD would like to retain this office and they have been in Vermillion for over 100 years.

Mr. Illes also told the committee that his offices have not yet looked for the particular clay used in the fracking material to see if South Dakota might be able to sell clay to the North Dakota oil field businesses. He added that no budget had been put together on what it would cost to map the area looking for that clay.

Industry Briefing

Mr. Ken Luff and Mr. Richard George, Luff Exploration Company, distributed a list of "Take-Away" points to the committee (**document #4**). Mr. Luff said that he started

drilling for oil in South Dakota (Harding County) in 1973 and has continued running one to three drilling rigs in the state since that time. He said that improvements in technology have made it possible to extract additional oil today in the same places they found oil years ago by horizontal drilling of existing vertical wells.

Mr. Luff said that economics has slowed his company down. He said that every new government regulation adds to the cost, as does the increasing price of supplies and transportation. He said that right now, each well costs about \$3 ½ million while in 2005 they each cost about \$2 million. The operating cost for each rig today ranges from \$7,000 to \$12,000 per month. He asked the committee to keep the taxes where the industry can handle it economically.

Mr. Luff said that his company has done their best to treat everyone fairly. He said that South Dakota should encourage other companies to come here and explore. At this time, it is too big a risk for his company to explore outside Harding County.

Blu Halsey, Director of Government Affairs, Continental Resources, said that he disagreed with the *Summary of Findings* statement (pg. 33) that South Dakota does not need to offer tax incentives to draw in drilling companies. He explained that economics plays a large part in a company's decision on where to explore for oil and tax breaks may give a company just the right incentive to come look at new areas in South Dakota.

John W. Morrison, Crowley Fleck PLLP, Bismarck, ND, gave a PowerPoint presentation regarding the legal aspect of minerals rights and severance taxes (**document #5**). His law firm does almost exclusive work for oil and gas litigants. In both North and South Dakota, the surface owner has the right to receive compensation for damages and losses. One issue may be to establish annual payments and a methodology on how to arrive at a fair amount.

In North Dakota, the Agriculture Department offers mediation between landowners and oil companies and that process seems to work quite well. Landowners complained that the oil companies did not talk to them about the location of the well before drilling. The ND Legislature changed the law so that now oil companies must give two notices to the landowner before drilling begins. There is also an annual payment for loss of agricultural production to the landowner. This does reduce the front end payment as these damages are paid over the duration of the life of the well.

In response to questions, Mr. Morrison said that rather than focusing on how to reimburse for damages, they are trying to find ways to avoid the damages.

North Dakota Legislator Perspective

Senator Rich Wardner, Dickinson, ND, joined the meeting via teleconference.

Senator Wardner said that the Dakotas have a lot in common and that we need to work together.

He suggested that South Dakota have a planner go out to the area of the state where exploration is possible and take an inventory of the area. The following are just some of the categories that need to be inventoried:

- i. Housing – where can temporary housing be set up
- ii. Permanent housing
- iii. Where will the water come from; wastewater; what upgrades will be needed and what will they cost
- iv. Schools
- v. Electricity
- vi. Industrial park – the county needs to control where the industrial park is located – the oil industry should not be allowed to make that decision
- vii. There will need to be a place for trucks such as a truck stop of some kind and at the very least a diesel filling station.

Senator Wardner responded to questions from the committee. He said that it would be good to have four lanes on Highway 85 all the way through South and North Dakota. That is a long range goal, so for now focus may be construction of turning lanes. In certain areas, passing and turning lanes need to be installed and/or the road needs to be widened for safety purposes. This should be done now – be proactive, not reactive.

Senator Wardner urged the SD Department of Transportation to inventory the roads and bridges in the affected area. The counties will need help in fixing those roads and bridges if they are impacted by the heavy truck traffic. He added that the oil companies do build and maintain the roads out to the well site. The oil companies may even help with winter maintenance on county/state roads because they need to be able to get the oil transported.

School and Public Lands Office Briefing

Commissioner Jarrod Johnson, SD School and Public Lands, talked to the committee about oil well drilling on lands owned by School and Public Lands. He talked about the bidding process on the oil leases, the terms of the lease agreements, royalty payments, and the trust fund.

Overview of Legislative Options and Policy Considerations

Reuben D. Bezpaletz, Chief Analyst for Research and Legal Services, presented a checklist for the committee to use while considering possible legislation (**document #6**). He said that he and his staff would be drafting legislation for the next committee meeting.

Public Testimony

Tim Brown, Harding County, said that he is losing a lot of money because of the oil wells on his land. The oil companies take a lot of land needed for production. When he first moved onto his land, there were four oil wells, now there are sixteen oil wells. And, during that time, animal production has dropped about \$120,000.

David Niemi, Harding County, handed out two copies of surface use agreements (**documents #7 & 8**). He testified that they need more law enforcement in their part of the state. He said that driving 65 mph means traffic is flying past you and it is very dangerous.

Mr. Niemi said that several wells are just left abandoned with junk and dangerous holes remaining that hinder livestock production. These sites have not seen any reclamation. He also said that often equipment just shows up on his land for drilling wells and no one has ever contacted him, the landowner. He believes the production company should be required to give notice to the surface owner.

Mr. George with Luff Exploration agreed with Mr. Niemi. He said that there should be no activity without first giving notice to the landowner. He said that Luff Exploration goes out and meets with the landowner in person. He also said that there should never be abandonment of a well without reclamation. He suggested that the amount of the bond be raised to give incentive to the companies to complete reclamation.

Reese Clarkson, Buffalo, SD, distributed pictures of damage that has been done to his land (**documents #9 & 10**). He said there are 45-50 active wells on his land. This negatively affects his income. He said that he is forced to work around the oil wells; they do not work around him. He has to fit his operation to accommodate their operation. He would like to see the landowners receive just compensation.

Ron Slaba, Ludlow, SD, said that the landowners are not asking for additional income, they are asking for compensation for loss of income.

Robert Johnson, Harding County, SD, said that they do not want to run oil companies out of the area, but they would like them to take care of the people who own the land from where the oil comes. He said that he would forego the upfront payment for an annual payment. He would like to see some type of mediation program set up because what works for him may not work for the next guy. Each situation may need to be handled individually.

Dave Fischer, Zap, ND, is a land owner, mineral rights owner, and has worked for the oil companies. He believes that the opportunity for mediation would be a good thing for everyone involved.

Committee Discussion

When asked if the Department of Agriculture would be equipped to handle mediation between oil companies and landowners, Mr. Sanderson said that a bill had passed last year establishing a mediation office within the Department of Agriculture. He said he did not know if that office would be able to handle this type of mediation or not. He said that they would need some legislation to change that statute adding this duty to the mediation office.

Representative Spencer Hawley said that they should look at setting higher bond rates. He also would like to make it mandatory that the oil companies list their fracking ingredients on a website.

Representative Tona Rozum asked that legislation be drafted concerning abandoned mineral interests and North Dakota bonding requirements.

Senator Billie Sutton added that he would like to see a seven day notice of staking requirement. The landowners need proper notification.

Senator Ryan Maher requested a fiscal report on what it would cost to move the Geological Survey office to either Pierre or Rapid City. He also would like the geologists to let them know what it would cost to map clay fields in South Dakota.

Representative Betty Olson added that she would also like to see them investigate what types of sand are needed for the oil wells and if that sand may be found in South Dakota.

After additional discussion, Mr. Illes said that he will redirect his staff to start researching the sand and clay deposits in South Dakota.

Senator Tom Nelson said that legislation should be written making counties the trustees for abandoned mineral rights and to provide money for an impact fund for landowners.

Representative Charles Hoffman suggested lowering the sales tax rate on wells outside the current oil field area to encourage development.

Senator Larry Rhoden requested a review of animal theft statutes.

In response to questions about bonds for oil exploration, Mr. Townsend said that they do have an inspector who goes out to the site if requested by the landowner. They do have procedures for dealing with violations, but if the company is out of business there is not much that can be done. The bonding could help offset some of the costs in those situations. He said that the limits on bonds are set through statute. He added that no bond has ever been called for an oil and gas well in South Dakota.

Chair Solum said that the next meeting will be held on October 30. They need eight votes to take proposed legislation to the executive board, so all members are encouraged to be at that meeting.

Adjourn

SENATOR RHODEN MOVED, SECONDED BY SENATOR SUTTON, TO ADJOURN. The motion passed unanimously by a voice vote.



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