

Date Issued: May 7, 1986 (AGO 86-19)

Requested by: Board of University and School Lands

- QUESTION PRESENTED -

Whether the Board of University and School Lands has the authority to agree to the shut-in of marginally economic wells which currently produce oil from state lands.

- ATTORNEY GENERAL'S OPINION -

The Board of University and School Lands has the authority to agree to the shut-in of marginally economic wells which currently produce oil from state lands.

- ANALYSIS-

The question presented arises because of the rapid and severe decline in world crude oil prices since January 1986. Producing wells which might be profitable at higher prices are now unprofitable or marginally economic to operate. The oil industry has requested both the state and federal governments to allow operators to shut-in (or temporarily cease production on) marginally economic wells on public lands. This request would allow any such shut-in well to be put back on production at minimal cost. If marginally economic wells are not temporarily shut-in, but are plugged and abandoned instead, the possibility of reentry, which would be at a substantially higher cost, is unlikely. Plugging marginally economic wells would most likely result in permanent loss of the reserves under those wells.

In response to the request, the Board of University and School Lands is considering a policy allowing temporary shut-in of marginally economic wells by agreement. The proposal would require the payment of a shut-in royalty as consideration and limit the period of shut-in to one year. In addition, the Board would reserve the right to revoke any shut-in agreement if economic or other considerations so required.

The Board of University and School Lands (Board) was created by and received its authority from the North Dakota Constitution. N.D. Constitution Article IX, section 3 states that the Board was created to have "control of the appraisalment, sale, rental, and disposal of all school and university lands, and the proceeds from the sale of such lands" N.D. Constitution Article IX, section 1 provides that the proceeds of public lands "shall be and remain a perpetual trust fund" School and university lands were received by the State of North Dakota pursuant to the Enabling Act, which provided for some restrictions upon the sale and leasing of the lands conveyed by that Act. Section 11 of the Enabling Act, as amended, provided that states may lease their lands for the production of oil and gas "for such term of years and on such conditions as may be from time to time provided by the legislatures of the respective states;"

The Board's authority is constitutional in origin. "The source of authority of the board is the constitution itself and not the legislature. When the legislature acts with respect to the powers of

the board, it acts in a restrictive capacity and not as a conferrer of authority. . . ." (Citation omitted.) State v. Amerada Petroleum Corp., 49 N.W.2d 14, 23 (N.D. 1951). This means that the Board has any and all authority not specifically prohibited by statute. We look to the Statutes not to determine the scope of the Board's authority, but to determine if there are any restrictions thereon.

The Legislature reiterated the powers of the Board in N.D.C.C. section 15-01-02(1). This statute states, in pertinent part, as follows:

15-01-02. POWERS - CONTROL OF PUBLIC LANDS AND PERMANENT FUNDS. The board shall have:

1. Full control of the selection, appraisalment, rental, sale, disposal, and management of:
 - a. Lands donated or granted by or received from the United States or from any other source for the support and maintenance of the common schools.
 - b. All lands which shall fall to the state by escheat.
 - c. All lands donated or granted by or received from the United States or from any other source for the maintenance of the educational, penal, or charitable institutions.
 - d. All lands acquired by the state through the investment of the permanent school funds of the state as the result of mortgage foreclosure or otherwise.

* * *

The Legislature also restricted the authority of the Board as it relates to leasing for oil and gas development in two chapters of the Century Code. N.D.C.C. chapters 15-05 and 38-09 concern leasing for oil and gas development on state lands. N.D.C.C. section 15-05-09 provides the Board with the authority to make rules and regulations for oil and gas exploration and development. N.D.C.C. section 38-09-15 requires a public offering of state leases. N.D.C.C. section 38-09-18 requires certain terms to be included in oil and gas leases for public lands, among which is the clause "All leases hereunder shall be made for a period of not less than five years and shall continue in effect under the terms thereof as long as oil or gas may be produced thereon in commercial quantities. . . ." Finally, N.D.C.C. section 38-09-19 provides that a lease not let in accordance with the chapter is (with some exceptions) void.

The Board has the authority to lease state lands for oil and gas exploration and production. State v. Amerada Petroleum Corp., 49 N.W.2d 14 (N.D. 1951). This would include the authority to enter into contracts concerning the same.

The Board's proposal would be implemented by agreement between the parties on a case-by-case basis. As such, the proposal would constitute a modification of, or supplement to, the

original lease contract. The power to contract necessarily implies the power to amend the contract.

. . .>the parties to any contract, if they continue interested and act upon a sufficient consideration while it remains executory, may by a new and later agreement . . . alter or modify it in any respect, add to or supplement it, or replace it by a substitute. . . . 17 Am. Jur.2d Contracts section 459 (1964).

The Board's constitutional authority to contract is not specifically prohibited by statute. This authority includes the authority to amend or modify a contract.

Two secondary questions remain. The first is whether the language of N.D.C.C. section 38-09-18 requiring a specific lease term "as long as oil or gas may be produced thereon in commercial quantities. . . ." limits the Board's authority to amend its lease to allow for temporary shutting-in. The second is whether the public notice and bid letting process set forth in N.D.C.C. chapter 38-09 limits that authority.

Most oil and gas leases, whether public or private, provide for a specified primary term and a secondary term, the language of which differs in different lease forms. The clause setting forth the primary and secondary term of the lease is called the habendum clause. North Dakota state lease forms are required to have an habendum clause in compliance with N.D.C.C. section 38-09-18. N.D.C.C. section 38-09-18 was initially enacted by the 1951 Legislative Assembly. The habendum language has not been changed since then. Our state lease forms now incorporate the language found in N.D.C.C. section 38-09-18. Previous lease forms used similar language. (There are a total of five different lease forms in effect today, although only one is the form used for new leases.)

Often there are other clauses in a lease which affect the operation of the habendum clause. These other clauses are commonly called savings clauses. Savings clauses operate to extend the primary and/or secondary terms of the lease when the lease might otherwise terminate under the habendum clause.

For instance, if under the primary term of the lease a lessee begins drilling operations and is interrupted because of war or riot, a force majeure clause would save the lease from termination. If under the secondary term of the lease discovery of gas is found but marketing cannot occur, the shut-in gas clause would save the lease from termination.

In the situation before us, the Board of University and School Lands proposes to modify the lease by agreeing to another type of savings clause. This modification would permit a shut-in due to extremely depressed market conditions and, as such, will operate to save the lease from a termination which might otherwise occur under the habendum clause.

Savings clauses are specifically allowed under a Board regulation. Rule 85-06-06-05 states as follows:

85-06-06-05. FORM AND TERMS OF LEASE. Leases shall be issued on forms furnished by the commissioner. All leases shall be made for a term of not less than five years and shall continue in effect under the terms thereof for as long as oil and/or gas may be produced from the leased premises in commercial quantities or for as long as extended as provided therein. The lease may provide for a reasonable shut-in clause, force majeure clause, and drilling and reworking continuation clause. The lease shall 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 state land department at the time the lease is issued. The lease shall provide for a royalty of not less than one-eighth of all oil and gas produced from the leased premises. The fraction of percentage established by the board as a royalty shall be construed to mean such fraction or percentage of the net mineral interests. The lease may contain such terms and conditions as the board or commissioner shall deem appropriate. (Emphasis supplied.)

The above administrative regulation specifically provides that the lease may include a shut-in clause, force majeure clause, and drilling and reworking continuation clause.

The regulations of the Board provide for discretion in the Board and the commissioner in determining what the lease contract should contain. Some lease clauses are required and some are permissible. In addition, the last sentence of Rule 85-06-06-05 allows the lease to contain additional terms and conditions as the Board or commissioner deems appropriate. Since these additional clauses and terms are not prohibited by the language of N.D.C.C. section 38-09-18, neither would the Board's proposal be prohibited by that statute. The proposal is merely a supplement or modification of an existing contract, similar to terms and clauses specifically allowed in state leases under Board regulations.

The remaining question, then, is whether the public notice and bid letting process set forth in N.D.C.C. section 38-09-15 and Rule 85-06-06-03 prohibit such an amendment. N.D.C.C. section 38-09-15 states:

38-09-15. PUBLIC OFFERING OF LEASES - STATE. Before leasing any land or interest therein or any mineral rights reserved therein, the state of North Dakota . . . shall first advertise the lands offered for lease . . . the notice as published shall contain a statement showing the legal description of the lands to be leased, the time and place where the lease will be held and such other information as may be deemed by such state or department or agency thereof to be applicable. . . .

Rule 85-06-06-03 states:

85-06-06-03. ADVERTISEMENT AND PUBLIC AUCTION. . . . The published notice shall contain the legal description of each tract, the time and place where the leasing will be held, the term of the lease, minimum annual rental and the minimum bonus.

. . .

When state land leases are auctioned, those persons bidding usually have an idea of what lease form will be used because the state lets all tracts on the same lease form. Persons who bid on any particular lease, which now may be altered by a shut-in agreement, would have bid on different terms than the modified lease will provide.

In my opinion this circumstance does not prohibit the Board from exercising its discretion when necessary. The statutory and regulatory requirements for the public offering cover only the lease description, the time and place of the leasing, the term of lease, the minimum annual rental, and the minimum bonus. Regulations of the Board specifically allow the Board or commissioner to include terms in addition to those specified in the notice. We assume that the minimum notice requirements were met in all of the notices for leases which the Board now has in effect. Subsequent modifications of those leases will not invalidate the initial public offering process.

It is my opinion that there is no statutory prohibition against the Board of University and School Lands agreeing to allow the shutting-in of marginally economic wells which currently produce oil from state lands.

- EFFECT -

This opinion is issued pursuant to N.D.C.C. section 54-12-01. It governs the actions of public officials until such time as the question presented is decided by the courts.

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