BUSINESS

Dispute Flares Over Burned-Off Natural Gas

Mineral Rights Owners Aren't Satisfied With Payment Offer From One North Dakota Driller

By CHESTER DAWSON

Aug. 3, 2014 7:24 p.m. ET

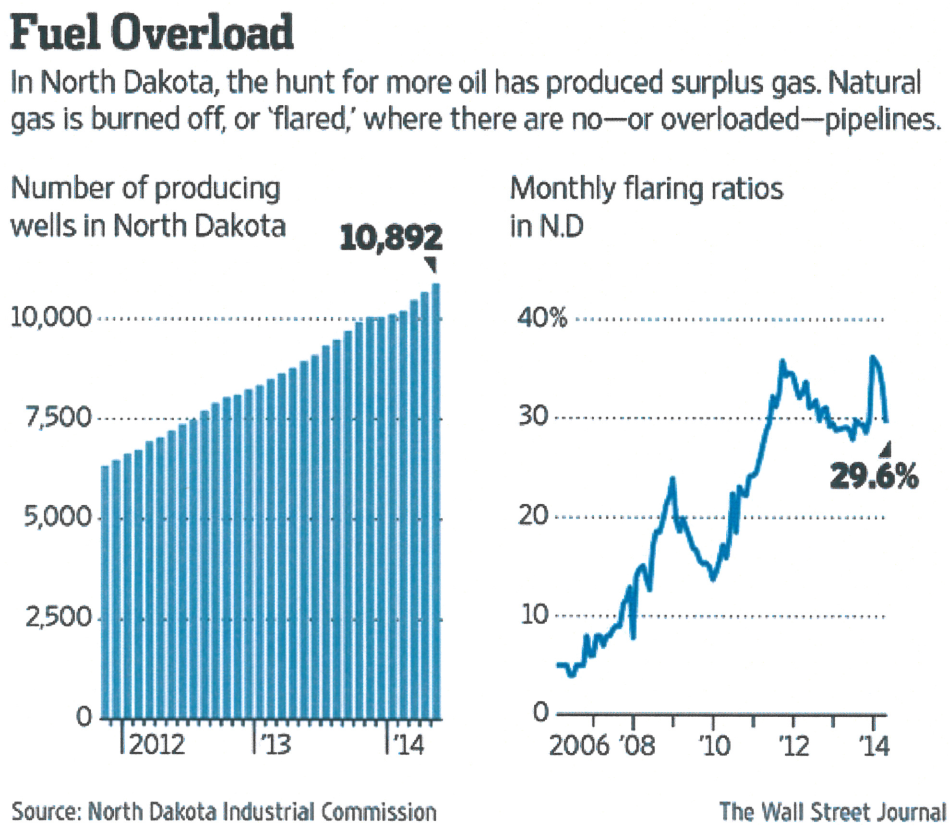
The burn-off flame of natural gas lights up the night sky in Williston, N.D. in this June photo. *Associated Press*

It isn't every day that an energy company tries to give away cash, but one of the biggest oil producers in North Dakota is trying to do just that.

Continental Resources Ltd. says it wants to pay state taxes and make royalty payments on natural gas it improperly burned off at dozens of wells in recent years. The company is asking state regulators to approve its plans, including the value it is assigning to the gas that was burned in the controversial practice known as flaring.

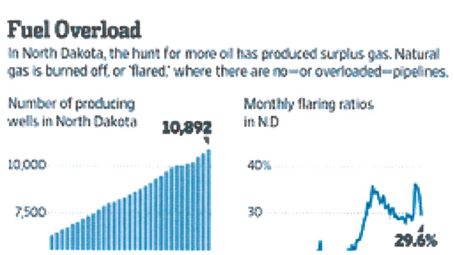
"We believe we're the first operator out there asking to be allowed to pay royalties and taxes," said Brooks Richardson, Continental's director of risk enterprise management. Continental and other North Dakota drillers say they were forced to burn off gas they would have rather sold but for the lack of capacity on the state's existing network of pipelines.

But lawyers for some of the land and mineral-rights owners who have sued Continental over what they say are unpaid royalties contend that the company's main goal is to minimize its liability as the state finally moves to curb flaring. Natural gas that is pumped out of the ground along with more valuable oil is burned at a much higher rate in North Dakota than in other crude-producing states, a legacy of the industry's rush to pump oil before gas pipelines and processing plants were built.

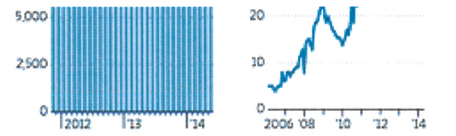


How to value the gas that has been burned off is up for debate. A lower value means less paid in royalties. Those owed royalties are pushing for a higher valuation than Continental wants. They are also pushing for royalties on flared gas the company says is legally exempt from royalty and tax payments under state law, including in cases where wells are hooked up to oversubscribed gas lines. Two-thirds of the gas burned off in North Dakota each month is from wells connected to gathering systems that are overwhelmed with too much gas and not enough processing capacity.

"It's a huge amount of money that is being burned off every month and a percentage of that is owed to the royalty owners," said Cody Balzer, a lawyer representing North Dakotans who say they should have been paid royalties for gas that was produced but burned rather than sold. "Collectively, it's millions of dollars a day."



Other companies that have been accused of failing to pay land owners or the state treasury for flared gas include Exxon Mobil Corp.'s subsidiary XTO Energy Inc., Hunt Oil Co. and Burlington Resources Oil & Gas Co., which is a unit of ConocoPhillips.



Source: North Dakota Industrial Commission The Wall Street Journal

Burlington and XTO said they comply with state rules on gas flaring. Hunt declined to comment.

A federal judge dismissed several class-action lawsuits over royalties on flared gas earlier this year on procedural grounds; the plaintiffs have appealed to the Eighth Circuit Court of Appeals.

North Dakota's oil production has soared in recent years, making the state second only to Texas in output, U.S. government data show. But while Texas burns off less than 1% of the gas it produces, North Dakota flares about a third of its gas.

The state recently adopted rules requiring companies to submit gas-capture plans to get new drilling permits. But regulators say they can't force companies to pay royalties. "That is really outside our jurisdiction," said Lynn Helms, director of North Dakota's Department of Mineral Resources.

Continental says it is making good faith efforts to compensate mineral rights owners at about 65 wells it owns out of a total of 860 in North Dakota where it thinks natural gas was flared when it shouldn't have been. The company and state regulators say that companies can flare gas for the first year a well is producing, but must stop unless the well is connected to a natural-gas pipeline. The idea is that companies would flare only gas that the pipeline couldn't accommodate.

The issue is beginning to percolate amid complaints oil producers aren't paying a higher price for burning off gas. Two Republican state lawmakers in Wyoming earlier this year proposed a bill to remove tax exemptions on flaring. The industry has pushed back, saying that losing exemptions on flaring would impose too high a cost and prevent them from drilling new wells.

"It's perceived as an unfair subsidy to the industry, but the industry is saying that if they have to capture the gas they can't drill wells. It's a chicken-and-egg problem," said Joshua Cannon, an attorney with Welborn Sullivan Meck & Tooley.

The company took a stab at estimating its potential liability in court filings last November, putting it "between $136 million and $218 million." But Continental now says those figures were calculated on terms requested by mineral-rights owners, and that the final amount is likely to be smaller. The company notes that it has paid royalties to more than 16,000 people in the last six years.

Continental bought some of the wells in question in late 2012 and says they are in remote locations where there were few pipelines and burning off the gas was the only option. "What's history is history. I think you need to put it into perspective," said Continental Vice Chairman Jeff Hume.

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