Ohio House Ways and Means Committee
The Honorable Tim Schaffer, Chairman

Opponent Testimony on
Severance Tax Provisions in
House Bill 49

Presented By:
Chris Zeigler, Executive Director
American Petroleum Institute Ohio
March 14, 2017

Chairman Schaffer, Vice Chairman Scherer, Ranking Member Rogers and members of the House Ways and Means Committee, thank you for the opportunity to testify in opposition to the severance tax provisions in House Bill 49, the main operating budget of the 132nd General Assembly. My name is Chris Zeigler and I serve as the Executive Director of the American Petroleum Institute's division in Ohio (API Ohio).

The API is the only national trade association representing all facets of the oil and natural gas industry, which supports 9.8 million U.S. jobs and 8 percent of the U.S. economy. The API's more than 625 corporate members include major oil companies to the smallest of independents. They are producers, refiners, suppliers, marketers, pipeline operators, and marine transporters, as well as service and supply companies that support all segments of the industry. They provide most of the nation's energy and are backed by a growing grassroots movement of more than 30 million Americans. In Ohio, API member operations and investments have added billions of dollars in economic value throughout our state and the larger Appalachian region, and represent leaders in the development of the Utica/Point Pleasant shale play.

Currently, Ohio's severance tax is a volume-based tax imposed on oil and natural gas, and derivatives such as condensate and natural gas liquids, at a rate, including a regulatory fee, of $.20 per barrel of oil and $.03 per MCF of natural gas, respectively. These rates apply to oil and natural gas produced by both conventional and horizontal wells, the latter which exclusively utilizes hydraulic fracturing technology.

As intended, Ohio's current severance tax is an excise tax; a tax upon a certain activity, designed to defray certain costs unique to that particular activity. Unlike the proposal in H.B. 49, sound tax policy requires that Ohio's severance tax should continue to fund two divisions within the Ohio Department of Natural Resources: the Division of Oil and Gas Resources Management, that oversees drilling and the Division of Geological Survey, whose mission is "to provide geologic information and services needed for responsible management of Ohio's natural resources."

Ohio's current severance tax system works perfectly for its intended purpose, which is to fund the regulatory program. Increased oil and natural gas production equates to increased funds for Ohio's oil and natural gas regulatory program. Under today's system, every producer--from the state's conventional operators to the recent development by unconventional operators--funds Ohio's robust regulatory program. Unfortunately, as reported by LSC, "it is unclear what revenue would be used to support these divisions in the longer term."[1] The severance tax should not be used to fund a wide-scale reduction in some other tax of general application or for any other purpose outside current law.

As introduced, H.B. 49 replaces the existing volume-based oil and natural gas severance tax and cost recovery assessment with new value-based severance taxes on oil, natural gas, condensate, and natural gas liquids (NGLs). According to LSC, the new tax is based on the product of two variables – the "spot price" of severed natural gas, oil, condensate, or NGLs multiplied by the quantity of each resource severed from an oil or natural gas well. The Tax Commissioner is responsible for calculating the quarterly spot price for a unit of each hydrocarbon by averaging each day's closing spot price reported for that hydrocarbon during the quarter beginning six months before the current quarter, as reported by a publicly available source determined by the Commissioner. The spot price for condensate is based on the price of Appalachian condensate, and the spot price for NGLs is based on the price of one million BTUs natural gas plant liquids composite.

House Bill 49 proposes to tax oil and natural gas and its derivatives at the following rates:

- For oil, a tax rate of 6.5%;
- For natural gas that enters the natural gas distribution system without processing, 6.5%;
- For condensate collected at a point other than the wellhead, 6.5%;
- For natural gas liquids collected other than at the wellhead, 4.5%.
- For all other natural gas, 4.5%;

The revenue from the proposed severance taxes collected under HB 49 is to be credited to the General Revenue Fund.

On the top-end, the severance tax increase included in H.B. 49 represents a 2400 percent increase from the gross receipts tax that the oil and natural gas industry already pays through the Commercial Activity Tax (CAT). In order to protect the continued development of shale resources and all the benefits it provides to our state and for additional reasons that I will outline, API Ohio is opposed to the increased severance tax and corresponding revenue redistribution provisions in H.B. 49.

American Energy Renaissance

Over forty years ago, President Richard Nixon addressed the nation about necessary cutbacks on America's use of oil and natural gas, due to the impending oil embargo. Every President since Nixon has discussed the goal of decreasing America's dependence on foreign energy resources. That goal has become reality as U.S. domestic oil and natural gas production has increased significantly over the last few years. Although U.S. domestic oil and natural gas development has slowed since 2014, the U.S. remains an energy superpower.

We no longer debate American energy policy in terms of scarcity and the vulnerability of relying on energy resources from other nations. Now our energy future is discussed in terms of abundance, self-sufficiency and true energy security.

---

[1] LSC Analysis of Executive Budget, Department of Natural Resources, February 2017, http://www.lsc.ohio.gov/fiscal/redbooks132/dnr.pdf

This has only been possible because of the combination of two long-standing technologies, horizontal drilling and hydraulic fracturing. Geologists have always known that more oil and natural gas was trapped in shale formations, but without the necessary technology to economically drill and produce, the resources sat dormant.

Thanks to American ingenuity, shale regions across the U.S., including Ohio's Utica/Point Pleasant formation, accounted for 92% of domestic oil production growth and for all domestic natural gas production growth from 2011-14.[2]

In October 2013, for the first time in nearly two decades, the U.S. produced more crude oil than it imported.[3] Petroleum production grew to more than 12.7 million barrels per day of crude oil and natural gas liquids in 2015.[4] Despite lower prices in 2016, production remained above 12.3 million barrels per day.[5]

The U.S. is no longer constrained by the amount of oil and natural gas resources technically extractable; but rather the economics of extracting the resources and the policies that allow these opportunities to be pursued.

<u>The Benefits Provided By The Oil and Natural Gas Industry</u>

America's oil and natural gas industry supports approximately $1.2 trillion in U.S. gross domestic product and provides tens of millions of dollars each day to the federal government in the form of royalties and bonuses paid at lease sales and taxes.[6] In fact, operations in the U.S. generate separate state and federal income tax obligations or payments, causing the industry to have an effective tax rate above the federal statutory rate of 35 percent.[7] With the right federal energy policies, the oil and natural gas industry could support as many as an additional 1 million American jobs in 2025 and 2.3 million by 2035.[8]

Closer to home, Ohioans have realized the benefits from the development of our emerging shale resources over the last few years. Development that is having a tremendous positive impact on our economy and tax revenue--all under Ohio's current severance tax structure:

- <u>EMPLOYMENT</u>: According to the latest *Ohio Department of Jobs and Family Services Quarterly Shale Report,* employment in core and ancillary shale-related industries account for over

---

[2] U.S. Energy Information Administration, Drilling Productivity Report, February, 2017. http://www.eia.gov/petroleum/drilling/pdf/dpr-full.pdf

[3] U.S. Energy Information Administration, International Energy Statistics, http://www.eia.gov/cfapps/ipdbproject/iedindex3.cfm?tid=5&pid=55&aid=1&cid=RS,US,&syid=2009&eyid=2013&unit=TBPD

[4] U.S. Energy Information Administration, Petroleum Overview, https://www.eia.gov/totalenergy/data/monthly/pdf/sec3_3.pdf

[5] U.S. Energy Information Administration, Spot Prices, Petroleum and Other Liquids, https://www.eia.gov/dnav/pet/pet_pri_spt_s1_m.htm

[6] Wood Mackenzie for API, "A Comparison of U.S. Oil and Natural Gas Policies: Pro-development Policies vs. Proposed Regulatory Constraints," June 2015, http://www.api.org/~/media/files/policy/american-energy/pro-v-regulatory-constraints-22-june15.pdf

[7] Energy and Taxes, Economic Growth and Tax Fairness, February 2017. http://www.api.org/~/media/files/policy/taxes/energy-and-taxes/energy-and-taxes-primer-highres.pdf

[8] Wood Mackenzie for API, "A Comparison of U.S. Oil and Natural Gas Policies: Pro-development Policies vs. Proposed Regulatory Constraints," June 2015, http://www.api.org/~/media/files/policy/american-energy/pro-v-regulatory-constraints-22-june15.pdf

192,000 Ohio jobs. With nearly 14,000 shale-related business establishments spread across the state, the development of shale resources has not only revitalized some of Ohio's most economically distressed regions but also the entire state.[9]

- <u>HIGH PAYING JOBS</u>: Also reported in the latest *Ohio Department of Jobs and Family Services Quarterly Shale Report,* the four-quarter average wage, in core shale-related industry jobs, paid over $28,000 more than the average for all Ohio industries. Ohioans in jobs that support the oil and natural gas industry earn on average over $17,000 more than those in other Ohio industries. The average individual salary in core shale industries was nearly $76,000. The average salary in ancillary shale-related industries was more than $64,000.[10]

- <u>NEW INVESTMENT AND ECONOMIC GROWTH</u>: Tens of billions of dollars have already been invested in Ohio through shale resource development, infrastructure build-out as well market-based natural gas power generation in the state.[11][12]

- <u>REAL BENEFITS FOR OHIO FAMILIES, BUSINESSES, SCHOOLS AND GOVERNMENTS</u>: With the development of our Utica shale resources, the price of natural gas for electric generation has dropped by over 50 percent for Ohio consumers and over 30 percent for Ohio businesses.[13] In 2013, Ohioans paid over $200 million less for their natural gas compared to other states, a savings of more than $162 million for Ohio businesses, $60 million in savings for Ohio schools (enough to employ 700 teachers) and over $10 million in savings for state and local governments.[14] Lower energy costs is just one of the many benefits that natural gas production is bringing to Ohio consumers and businesses; only made possible by the technological advancements in hydraulic fracturing and the risks undertaken by unconventional operators.

- <u>"PAYING OUR FAIR SHARE":</u> In addition to the severance tax, Ohio's upstream oil and natural gas industry pays every tax that other Ohio manufacturers pay. These include income tax, sales tax, commercial activity tax (CAT), fuel use tax, employment related taxes as well as the industry specific ad-valorem tax. In 2012, unconventional development in Ohio generated nearly $1.5 billion in federal and state revenue; including more than $910 million in state and local taxes.[15] A newly released report shows that in just six eastern counties in Ohio, oil and natural gas

---

[9] *Ohio Department of Jobs and Family Services Quarterly Shale Report, 2016 Q2.* http://ohiolmi.com/OhioShale/Ohio%20Shale%20Report_2Q_2016.pdf

[10] *Ohio Department of Jobs and Family Services Quarterly Shale Report, 2016 Q2.* http://ohiolmi.com/OhioShale/Ohio%20Shale%20Report_2Q_2016.pdf

[11] Ohio sees $5.7B in new oil and gas infrastructure since spring, http://www.bizjournals.com/columbus/blog/ohio-energy-inc/2015/11/ohio-sees-5-7b-in-new-oil-and-gas-infrastructure.html

[12] Three Reasons Companies Have Invested Billions in Natural Gas Fired Power in Ohio, https://energyindepth.org/ohio/three-reasons-companies-have-invested-billions-in-natural-gas-fired-power-in-ohio/

[13] API: Natural Gas Lowering Energy Costs for Ohio, http://www.api.org/news-policy-and-issues/news/2016/07/20/api-natural-gas-lowering-energy-costs-fo

[14] The Unconventional Energy Revolution: Estimated Energy Savings for Public School Districts and State and Local Governments, IHS Global, Inc. June 5, 2014. http://www.api.org/~/media/files/policy/hydraulic_fracturing/ihs-govt-and-school-savings-june2014.pdf

[15] America's New Energy Future: The Unconventional Oil and Gas Revolution and the US Economy, IHS Inc., December 2012. http://www.api.org/~/media/Files/Policy/SOAE-2013/Americas_New_Energy_Future_State_Highlights_Dec2012.pdf

producers paid local property taxes totaling $43 million in four years and could pay up to $250 million over the coming decade.[16]

Recent Reality

The downturn in commodity prices over the last few years has significantly impacted operations of domestic oil and natural gas producers, oil field service companies, and supply industries across the U.S. and here in Ohio. In a report from last year, the collapse in crude oil prices translated into an estimated trillion-dollar retrenchment in capital investment by oil and natural gas producers around the world.[17]

For shale-developing companies operating in Ohio since 2014, reports have been equally sobering, with announced reductions in capital expenditure budgets compared to investments.[18] Although natural gas production levels have continued to grow, many companies have posted losses in revenue, citing lower commodity prices.[19] The full economic impact of lower commodity prices on our state's economy is yet to be determined.

There is never a good time to be the bearer of increased taxes, but for Ohio's oil and natural gas industry and supporting businesses, an increased severance tax could be devastating. This was certainly the logic when a leading tax reform association issued a statement regarding the last severance tax increase proposal Ohio, "Increasing taxes on Ohio's energy producers and small businesses could lead to more layoffs and set Ohio back in its economic recovery."[20]

Unfortunately, proponents of a severance tax increase in Ohio either discount or ignore recent economic trends impacting the oil and natural gas industry. For developers of shale resources now operating in our state, the reality has been higher capital costs and lower realized profits. Much of the Utica's natural gas has sold at a significant discount to the nationally quoted NYMEX Henry Hub Price and just last Friday, it was reported that U.S. crude fell below $50 a barrel for the first time this year.[21] In comparison, when I testified against a similar severance tax increase proposal in this very committee on March 3, 2015, the spot price for U.S. crude traded at $50.43. The fact is that Ohio drillers have been operating at a competitive disadvantage to other oil and natural gas producing states with our current severance tax. An increased severance tax is simply illogical for encouraging continued development of shale resources in our state.

Long-term considerations

Since 2011, Ohio severance tax increase proposals have not been presented in the context of an overall energy policy or taken into account other factors directly impacting the industry. The proposed tax increases are merely a means to an end objective that doesn't promote the industry's continued

---

[16] Shale gas and oil producers could pay $250 million in local property taxes, industry study claims, http://www.cleveland.com/business/index.ssf/2017/02/shale_gas_and_oil_producers_co.html

[17] Global oil industry's retrenchment tops a staggering $1 trillion, http://www.cnbc.com/2016/06/15/global-oil-industrys-retrenchment-tops-a-staggering-1-trillion.html

[18] http://www.bizjournals.com/columbus/blog/ohio-energy-inc/2015/02/energy-roundup-natural-gas-production-keeps.html

[19] http://www.cantonrep.com/article/20150506/NEWS/150509450/1377/FRONTPAGE

[20] http://www.atr.org/americans-tax-reform-responds-ohio-gov-kasich%E2%80%99s-income-tax-plan

[21] Wall Street Journal, March 10, 2017, https://www.wsj.com/articles/oil-sinks-to-3-month-low-as-u-s-crude-reserves-swell-1489058059

existence. During his testimony on H.B. 49 before the House Finance Committee last month, the director of the Office of Budget and Management substantiated this point by noting the "exception" to the "wealth of positive economic news" is the energy industry where low commodity prices "has had lasting negative effects on employment and earnings," as well as diminished "investment in that sector and related sectors."[22] The severance tax proposal in H.B. 49 certainly doesn't convey an interest in ensuring that overall policies are in place to encourage the continued development of shale resources in the state allowing all Ohioans to derive the greatest economic impact of the natural resources.

Studies have shown that in the long run, the negative economic consequences of higher taxes more than offset any short-term tax revenue gains. For example, according to an economic analysis by Wood Mackenzie, an additional $5 billion in new, annual taxes—similar to what had been proposed by the Obama Administration—was estimated to actually decrease cumulative government revenue by $29 billion.[23]

The full spectrum of Ohio's oil and natural gas industry has been and hopefully will continue to be an essential component of Ohio's economy for years to come. As such, API Ohio is fully committed to engaging in any policy discussions that support the continued growth of the oil and natural gas industry to the real benefit of all Ohioans. However, for the reasons I have detailed today, the severance tax proposal in H.B. 49 presents our industry with serious short- and long-term concerns in light of current economic conditions. As such, API Ohio respectfully request that consideration be given to removing the proposed severance tax increase language and corresponding revenue redistribution provisions in H.B. 49. Ohio's oil and natural gas industry has proven its potential for increased economic growth and job creation in our state Now, more than ever, we need a thoughtful, long-term approach to allow this opportunity to be fully realized by the state and its citizens.

[22] http://www.ohiohouse.gov/committee/finance

[23] Wood Mackenzie, "Energy Policy at a Crossroads: An Assessment of the Impacts of Increased Access versus Higher Taxes on U.S. Oil and Natural Gas Production, Government Revenue, and Employment," January 2011.
http://www.api.org/~/media/Files/News/2011/SOAE_Wood_Mackenzie_Access_vs_Taxes.pdf