Chairman Schaffer, Ranking Member Rogers and members of the House Ways and Means Committee, thank you for the opportunity to testify today regarding the severance tax provisions of House Bill 49 "As Introduced". I am Shawn Bennett and I serve as the Executive Vice President of the Ohio Oil & Gas Association (OOGA).

The Ohio Oil & Gas Association is a statewide trade association representing 2,100 members who explore for, develop and produce Ohio's crude oil and natural gas resources. Our membership consists of people who professionally represent all phases of the exploration and production (E&P) process and all sizes of producers, from small independents to major oil companies. The OOGA has represented Ohio's crude oil and natural gas producing industry since 1947.

I am here today, representing my membership's collective opposition to the severance tax increase as proposed in HB 49.

I would like to begin by addressing the current proposal and its impact on both our members and this industry.

Headlines published since December, 2014 have made it clear: our industry is in the middle of the worst economic downturn in the recorded history of the industry. And while the economic challenges remain today, I do not want to dwell on that fact in my testimony since it has been so well documented.

Instead I would like to focus on opportunity and specifically the opportunity that our industry is providing to Ohio, its residents and its economy. As a child of Appalachia, I have lived in the area where Utica Shale development has been taking place over the past several years. While my hometown is on the fringes of development, the positive impacts that it has had on my region of the state extends far beyond the unit boundaries of a well permit.

I have witnessed childhood friends afforded new opportunities, not only in the oil and gas industry, but in other industries that have been elevated to new heights picked up because of increased activity. Residual industries, such as automobile dealers, restaurants, and hotels, have seen tremendous growth. This growth can be attributed primarily to the influx of income to local landowners who leased their land for oil and gas development. My grandmother was lucky enough to lease her farm and, while it will most likely never be drilled, the lease payment she received allowed her to live on her farm comfortably until she passed away one and half years ago.

While individuals and local businesses continue to benefit from the success of oil and gas development, other markets also see benefits. The investments from pipelines, natural gas fired electric generation, the potential for an ethane cracker, as well as the general benefits of low natural gas prices that every Ohioan receives, are creating a resounding impact on the State of Ohio.

There are currently eleven natural gas fired power plants in different phases of planning or development that have been announced in the state. These plants have an estimated investment of nearly $10 billion that will generate over 11,000 megawatts of electricity, enough generation to power over 9 million homes, and support 6,000 construction jobs.

The promise of an ethane cracker in Belmont County has been a priority for both the state and JobsOhio, who has spent $14 million to clean up the site of proposed ethane cracker and has been quoted as saying that this project holds great prospects for the economic future of eastern Ohio. The potential exists in Ohio to extract one of the most important natural gas liquids for the production of plastics - ethane.

This ethane supply has the opportunity to attract over $6 billion of capital investment in Ohio from a single cracker plant. Ohio currently leads the nation in plastic manufacturing. These plastic companies contribute to finished consumer goods such as toys, household products, car interiors, computers and electronics. Once an ethane cracker is constructed and operating in the Appalachian Basin, the plastics industry can begin the transition from sourcing its materials from the Gulf Coast to Ohio due to ethane from locally-produced natural gas. .

Given the glut of natural gas that is regionally bottlenecked in the Appalachian Basin largely created by the Marcellus Shale to the east of us in Pennsylvania, our natural gas prices on the Dominion system are some of the lowest in the industrialized world. This is because the price Ohio oil and gas producers receive for their natural gas is discounted due to oversupply. This trend – called negative basis – means that producers receive less than the current market value for their natural gas. The price is lower because of the regional oversupply.

While we work on mitigating some of the negative basis that surrounds this issue, consumers and businesses who operate in eastern Ohio enjoy tremendous cost savings from the development of our oil and natural gas resources. These low prices have the ability to attract large industrial users of natural gas, like fertilizer plants, to locate in Ohio to capitalize on this plentiful low cost resource.

As a relief to the bottleneck, many miles of gathering and transmission lines have been built, with 5 new major pipeline projects either planned or under construction. The capital investment is estimated at $8.2 billion, for a total of 1,272 miles of pipeline that will transport over 8 bcf/d of natural gas away from the basin to more competitive markets. A report by Energy In-Depth Ohio found that these pipelines will generate $256 million a year in new property tax revenues for local governments through Ad Valorem.

Speaking of Ad Valorem, it is just one of the many taxes that the oil and gas industry pays from producing oil and gas wells in this state. To date, the oil and gas industry has paid $46 million to local governments in six shale producing counties over the past four years. Going forward, conservative estimates project those counties to be paid over $250 million over the next ten years. While this number may not seem large when looking at the overall state budget, it is a significant amount to these counties and their budgets.

Now looking at the provision included in House Bill 49, the OOGA has several concerns with the proposed severance tax increase. The current proposal changes our volumetric severance tax rate of $.03 an mcf and $.20 a barrel to a gross receipts tax of 6.5% on oil and natural gas collected at the wellhead or 4.5% on natural gas liquids and natural gas sold after processing.

Traditionally, the state has utilized a volumetric per barrel and per mcf approach to mirror industry activity in an effort to fund the regulatory program. When activity is high, the regulatory program's funds mirror the heighted activity. When activity is low, funds are dialed back.

Another concern with HB 49 is that the tax is an across-the-board increase on <u>all</u> Ohio oil and gas production. In the past iterations of the proposed severance tax increase, conventional operators were held harmless as a severance tax change was only proposed for horizontal operators. In HB 49, all oil and gas operators would face a 16-times greater severance tax then what they are paying today. Traditional Ohio "mom and pop" operators would now face a tax increase – a tax increase their current businesses could not bear. The result would be the shutdown of conventional operations, including family businesses and traditional Ohio companies.

As written in the current proposal, the state would give the authority to the Ohio Tax Commissioner to tax Ohio producers based on a daily spot price from a publicly available source, as determined by the Tax Commissioner. In essence, this proposal would give the commissioner free reign to tax the industry on its perceived value rather then the price the producer actually received.

This is more problematic when factoring in the current state of the Ohio natural gas industry. Operators who use Dominion South Point to transport their natural gas are faced with a significant negative basis. To put this into perspective, in October of last year operators received $2.00 an mcf less than producers who sold their gas through the Henry Hub, which is where New York Mercantile Exchange (NYMEX) gets their pricing.

Under this proposal, if NYMEX is trading at $3.00 an mcf and South Point trades at $2.00 the 6.5% severance tax suddenly becomes an effective rate of 9.5% at $2.00 an mcf . Going one step further, if prices reflect the negative basis that operators faced in October of 2016 then $1.00 natural gas would have en effective rate of 19.5% at $3.00. Let me remind you once again that under this proposal, the severance tax is a gross receipts tax and is paid whether or not the business owner makes a profit, the 19.5% rate is a gross receipts tax and is a staggering rate to imagine for OOGA's members.

Why should any industry in this state be taxed upon a price they don't receive? Would you expect Amazon to pay the CAT tax on revenues that one of their competitors received for their goods even if those revenues were higher than what Amazon received? Absolutely not.

The same can be said of the specifics of oil taxation in this proposal. Again, here, the tax commissioner is the one who determines the price he believes a producer should get for their oil. And again, what he may use is not actually the price received. He would most likely use the West Texas Intermediary posted price as the public source for oil in this proposal. However, the pricing of oil is not as simple as some assume. There are API gravities that determine the price of oil and what we are getting out of the Utica is <u>not</u> the same as the crude they are trading in Cushing, Oklahoma.

As of Monday, WTI prices for crude were $48.45 per a barrel of oil. At Ergon, a refinery right across the river in West Virginia, producers would receive $47.76 if they were lucky enough to have a similar quality crude oil. Sadly that is not the case. Roughly 10% of the oil produced in the Utica is a slightly higher API Gravity oil, which currently receives $41.99, $6.46 less than WTI pricing.

The vast majority of the oil collected at the wellhead from the Utica is actually condensate, 60.0 API Gravity and above, and not technically oil as the state incorrectly represents in their production numbers. Utica condensate only fetches $32.49, which is $15.96 less than WTI pricing creating an effective rate of at least 9.75%. Does this really sound fair to allow a tax commissioner to determine a company's price per a barrel when they show a lack of understanding different API gravities and how that effects prices paid on a barrel of oil?

The reality is that we have a severance tax that works for Ohio. Our volumetric tax is applied to all extractive industries for the sole purpose of funding our regulatory bodies. In other states where they use a gross receipts tax, all extractive industries fall into that category. This current proposal is attempting to pick winners and losers. The oil and gas industry is the only extractive industry being singled out. The coal, salt and aggregate industries all retain their volumetric status while oil and gas is now singled out and given a gross receipts tax – and singled out for the sole purpose of generating perceived additional income for the state's general revenue fund.

I want to be clear. The Utica is <u>a</u> shale play, not <u>the only</u> shale play around. We are lucky that Ohio is part of the shale revolution. However, when you look or try to compare the Utica play in Ohio to other states, we have to understand that not all shale is created equal. If you look at recent investments, companies are tripping over themselves to gain a larger position in plays like the Permian Basin in Texas. What you don't see is the same happening in Ohio.

Companies like PDC Energy have decided to suspend their drilling program in the Utica in favor of purchasing assets in the Permian and developing those instead. Hess, another major operator in the Utica, is continuing to suspend their Utica program until prices rebound and instead are drilling in the Bakken Shale in North Dakota.

While prices have somewhat rebounded from a disastrous low in 2016, Ohio has to remain cognizant of the fact that capital is fluid and mobile. One of the only advantages we have is a low tax rate. If you make our tax rate even middle of the pack, investment and development will decrease. It is just simple economics, capital follows the path of least resistance. Just look at Arkansas, who did something very similar several years ago. There is only one rig operating in that state today.

The State of Ohio, by implementing this tax, would add itself to a list of deterring parties, and in doing so, risks standing in opposition to those who would suffer the most as a consequence of its passage – Ohio's working families.

On behalf of our Association and its members, I thank you for allowing me to testify today in regard to this proposal. The Ohio Oil & Gas Association urges the House Ways and Means Committee to remove this measure from HB 49 and continue to foster a tax environment that encourages growth instead of stifling this once in a lifetime opportunity.

Respectfully submitted,

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