Ohio Legislative Service Commission

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Fiscal Note & Local Impact Statement

Bill: H.B. 133 of the 129th G.A. **Date**: March 22, 2011

Status: As Introduced **Sponsor**: Rep. Adams

Local Impact Statement Procedure Required: No

Contents: Creates the Oil and Gas Leasing Board and establishes a procedure for leasing state lands for oil and gas drilling

State Fiscal Highlights

New funds

- The bill creates the State Land Royalty Fund to collect lease payments and royalties from oil and natural gas production on lands controlled by state agencies. Money in the fund would be used for operating and capital expenses of state agencies in proportion to each agency's share of the revenues.
- The bill creates the Oil and Gas Leasing Board Administration Fund to consist of a percentage of lease revenues as determined in administrative rules. The fund would be used to pay for the administrative costs of the Board.

Potential revenues

- The state could realize royalty revenues in the first full year of production ranging from the hundreds of thousands of dollars to approximately $9 million, depending on factors such as the level of production and market prices.
- Revenues from lease payments would depend on the location and market value of the parcels of land nominated for leases.
- Additional oil and gas severance tax revenues to the Oil and Gas Well Fund (Fund 5180) and the Geological Mapping Fund (Fund 5110) could range from the tens of thousands to the hundreds of thousands of dollars in the first full year of production, depending on the level of production.
- The Oil and Gas Well Fund (Fund 5180) could receive some new revenue from additional permit and regulatory fees related to new drilling, depending on the number of wells drilled and the level of production.

Potential costs

- The Division of Mineral Resources Management in the Department of Natural Resources could incur some additional administrative costs associated with the Oil

and Gas Leasing Board and oversight of drilling on state lands. These costs could be offset by lease and fee revenues.

Local Fiscal Highlights

- The bill has no direct effect on local political subdivisions. However, local governments in areas where state lands are leased for drilling may incur certain indirect costs related to public safety concerns, such as responding to well or storage tank fires, spills, or other such incidents.

Detailed Fiscal Analysis

Oil and Gas Leasing Board

The bill creates the Oil and Gas Leasing Board and grants it the exclusive authority to lease state lands for the exploration for and production of oil and natural gas. The Board is to consist of five members, two of which are officials within the Department of Natural Resources (DNR): the Chief of the Division of Mineral Resources Management (DMRM) and the Chief of the Division of Geological Survey. The remaining three members are to be appointed by the Governor, with two representing the oil and gas industry and one representing a statewide environmental organization. Members would not be compensated, but would be reimbursed for necessary expenses incurred in the course of their duties as board members.

Under the bill, the Board would receive and consider nominations for parcels of state land to be leased for drilling. The bill lays out aspects that the Board must consider when deliberating on a parcel, the procedures for approving and denying a nomination, the procedures for advertising for and submitting lease bids, and requirements for administrative rules that the Board must adopt (see the LSC bill analysis for further information on these requirements).

The bill requires DMRM to provide administrative support to the Board if so requested. This could result in additional administrative costs to DMRM, likely from the Oil and Gas Well Fund (Fund 5180), which is used to oversee oil and gas regulation. As the bill does not explicitly provide for start-up costs related to the Board before any lease revenues are deposited into the Oil and Gas Leasing Board Administration Fund, presumably such costs could be paid from Fund 5180.

Oil and Gas Leasing Board Administration Fund

The bill creates the Oil and Gas Leasing Board Administration Fund to pay for the administrative costs of the Board, including the expenses incurred by the members. The fund is to be capitalized by a percentage (to be determined in administrative rules) of the proceeds of bids received for the lease of state lands for oil and gas exploration or production. Because the amount collected in leases would depend on the location and value of the parcel of land being leased, the amount of revenue deposited into the fund is likely to vary from lease to lease.

State Land Royalty Fund

The bill creates the State Land Royalty Fund to receive lease proceeds and royalties, less the percentage that would be collected by the Oil and Gas Leasing Board Administration Fund under rule. Money would be deposited into the fund on behalf of the state agencies whose land is being leased. Money in the fund would pay for capital and operating costs of state agencies in proportion to each agency's share of the revenues.

Potential royalty revenues

The bill requires that lease agreements developed under administrative rules contain a one-eighth (12.5%) landowner royalty provision. Standard industry practice is for royalties to comprise a percentage of the market value of the product at the wellhead. In 2010, the average wellhead price of oil in Ohio was $74.42 per barrel (bbl) and the average wellhead price of natural gas was $4.68 per thousand cubic feet (mcf), according to DNR's 2010 *Summary of Ohio Oil and Gas Activities.* This compares to current prices, as of March 18, 2011, of $95.75/bbl for oil and $3.90/mcf for natural gas, per the Ohio Oil and Gas Association's Ohio Market Report. According to the DNR report, the total volume of oil produced in Ohio in 2010 totaled approximately 4.8 million barrels, and the total volume of natural gas totaled approximately 78 billion cubic feet, or 78 million mcf. Table 1 below illustrates the potential total revenues that could be realized in the first year of production at average 2010 prices, as well as March 2011 prices, if drilling on state lands results in a 1%, 5%, or 10% increase over statewide production levels for 2010 at a 12.5% royalty rate.

Table 1. Possible Range of Royalty Revenues from State Lands in First Year of Production (Royalty = 12.5%)

		Potential Revenues	
Resource	**% Increase in Production (Over 2010 Levels)**	**2010 Average Price ($74.42/bbl, $4.68/mcf)**	**March 2011 Price ($95.75/bbl, $3.90/mcf)**
Oil	1% (48,000 bbl)	$446,520	$574,500
	5% (240,000 bbl)	$2,232,600	$2,872,500
	10% (480,000 bbl)	$4,465,200	$5,745,000
Natural Gas	1% (780,000 mcf)	$456,300	$380,250
	5% (3,900,000 mcf)	$2,281,500	$1,901,250
	10% (7,800,000 mcf)	$4,563,000	$3,802,500

As shown in the table, if the first year of drilling on state lands yielded an increase in oil and gas production of 1% over 2010 levels at a 12.5% royalty rate against 2010 average prices, the state could gain a total of $902,820. At March 2011 prices, the same increase in production would yield $954,750. At the upper end of the range, with a 10% increase in production, the state could receive approximately $9.0 million in royalties at 2010 average prices, or $9.5 million at March 2011 prices.

These figures represent estimates of potential revenues from the first year of production only. Actual revenues and their continuation over time would depend on a number of factors, including (1) the amount of land actually leased for drilling, (2) the length of the leases, (3) the number of wells that actually produce oil and gas during the term of a lease, (4) the amount of oil and gas that is actually recoverable and depletion, and (5) fluctuations in the market price of oil and gas during the term of the leases.

Other potential revenues

Severance taxes

Table 2 shows a hypothetical range of severance tax revenues that Ohio could realize in the first year of oil and gas drilling on state lands using the Ohio severance tax rates of 10 cents per barrel of oil and 2.5 cents per thousand cubic feet of natural gas. As in Table 1, these estimates assume a 1%, 5%, or 10% increase in overall production over 2010 levels as a result of drilling on public lands. Under current law, unchanged by the bill, of the total amount collected in oil and gas severance taxes, 90% is deposited into the Oil and Gas Well Fund (Fund 5180) for the administration of DNR's oil and gas regulatory and well plugging programs, and the remaining 10% is deposited in the Geological Mapping Fund (Fund 5110) for use by the Division of Geological Survey.

Table 2. Possible Range of Additional Severance Tax Revenues from State Lands in First Year of Production

Resource	% Increase in Production (Over 2010 Levels)	Potential Revenue
Oil	1% (48,000 bbl)	$4,800
	5% (240,000 bbl)	$24,000
	10% (480,000 bbl)	$48,000
Natural Gas	1% (780,000 mcf)	$19,500
	5% (3,900,000 mcf)	$97,500
	10% (7,800,000 mcf)	$195,000

As Table 2 shows, a 1% increase in oil and gas production would result in additional total severance tax revenues of $24,300, while a 10% increase in production would generate $243,000. Again, however, these represent only hypothetical estimates for the first year of production. Ongoing actual revenues from severance tax collections would depend on the same factors that affect royalty income.

Permit and other fees

Under current law, new oil and gas wells drilled in Ohio are subject to various permitting and regulatory requirements, including fees, administered by DMRM. Any new wells drilled on public lands would also be subject to these requirements. According to the 2010 *Summary of Ohio Oil and Gas Activities*, there were 431 new wells drilled in Ohio in 2010. Presumably, drilling on public lands would result in some additional drilling activity and a corresponding increase in permit fees.

The fees most applicable to new wells are drilling permit application fees and regulatory cost recovery assessments. Fees for permits to drill new wells are based on the location of the well: $500 per well for townships with a population of less than 10,000; $750 for townships with populations between 10,000 and 15,000; $1,000 for townships with populations of 15,000 or more, or any municipal corporation; and

$5,000 for any well that requires mandatory pooling. The amount of permit revenue generated by drilling on state lands would depend on the number of permits issued and the physical location of the wells. However, given that most DNR-owned land is in areas with lower populations, it is likely that the permit fees charged for drilling in state parks or forests would tend towards the $500 or $750 amounts.

Regulatory cost recovery assessments were enacted in S.B. 165 of the 128th General Assembly to replace GRF funding as a source for DMRM's administrative costs for the oversight of oil and gas operations. Like Ohio's severance taxes, these assessments are based on the amount of oil and gas produced. Regulatory cost recovery assessments are 10 cents per barrel of oil and 0.5 cents per thousand cubic feet of gas. Table 3 below shows a hypothetical range of revenues from these assessments in the first year of production on state lands at increased production levels of 1%, 5%, and 10% over 2010. As above, actual figures would depend on actual levels of production over time.

Table 3. Possible Range of Regulatory Cost Assessment Revenues from State Lands in First Year of Production

Resource	% Increase in Production (Over 2010 Levels)	Assessment Revenues
Oil	1% (48,000 bbl)	$4,800
	5% (240,000 bbl)	$24,000
	10% (480,000 bbl)	$48,000
Natural Gas	1% (780,000 mcf)	$3,900
	5% (3,900,000 mcf)	$19,500
	10% (7,800,000 mcf)	$39,000

In addition to these fees, DMRM also charges fees for a number of other purposes. Wells drilled on state lands could be subject to many of these fees, depending on their use and how they are managed. These include fees for the plugging of abandoned wells, brine injection permits, well injection substance disposal, temporary inactive well status, transferring ownership of a well, and expedited review of certain permits. Income from these sources would likely not substantially affect the total revenues attributable to drilling on state lands. Additionally, while drilling on state lands would likely result in additional administrative costs to DMRM for the oversight of these activities, the revenues from severance taxes, permit fees, and regulatory cost recovery assessments would likely offset at least some, if not all, of these costs.

Potential indirect local costs

Local governments in areas where state lands are leased for oil and gas development may incur some minimal indirect costs for public safety concerns related to oil and gas wells. While DMRM is the agency responsible for overseeing and

regulating oil and gas wells, local fire departments and law enforcement agencies are the entities that act as first responders for fires and other incidents at wells and storage tank batteries. Such incidents are uncommon, but their occurrence could result in some local costs.

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