Ohio Legislative Service Commission

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Fiscal Note & Local Impact Statement

Bill: Am. Sub. H.B. 133 of the 129th G.A.

Date: May 31, 2011

Status: As Passed by the House

Sponsor: Rep. J. Adams

Local Impact Statement Procedure Required: No

Contents: Creates the Oil and Gas Leasing Commission 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 in the state treasury to collect lease payments and royalties from oil and natural gas production on lands controlled by state agencies, except for the Department of Natural Resources (DNR). Money in the fund would be disbursed by the Office of Budget and Management (OBM) for land acquisition and capital expenses of state agencies in proportion to each agency's share of the revenues.
- The bill creates two custodial funds outside the state treasury to collect lease payments and royalties from oil and gas production on lands controlled by DNR's divisions of Forestry and Parks and Recreation, respectively. These funds would be used to pay for land acquisition and capital costs of these divisions.
- The bill requires lease payments and royalties from oil and gas production on lands controlled by DNR's Division of Wildlife to be deposited into the Wildlife Habitat Fund (Fund 81B0) for land acquisition and wildlife conservation purposes.
- The bill creates the Oil and Gas Leasing Commission Administration Fund to consist of the proceeds of nomination and bid fees. The fund will be used to pay for the administrative costs of the Commission.

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 oil and gas 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

- State agencies will incur additional administrative costs to conduct inventories and classifications of their land holdings as required under the bill. The funding source for these costs will vary by agency, with the costs depending on the amount of land owned by each agency, among other factors.
- DNR's Office of Information Technology could incur additional GRF costs to maintain an inventory of state properties and their classifications on its web site.
- DNR's Division of Mineral Resources Management could incur some additional administrative costs associated with the Oil and Gas Leasing Commission and oversight of drilling on state lands. These costs could be offset by fee and severance tax revenues.

Local Fiscal Highlights

- The bill has no direct effect on 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 Commission

The bill creates the Oil and Gas Leasing Commission to oversee the process of nominating and leasing state lands for the exploration for and production of oil and natural gas, with the exception of state nature preserves, which the bill prohibits the state from leasing. The Commission is to consist of five members: the Chief of the Division of Geological Survey, two members representing the oil and gas industry, one member of the public with expertise in finance or real estate, and one member representing a statewide environmental or conservation organization. Members would not be compensated, but would be reimbursed for necessary expenses incurred in the course of their duties as commission members.

Under the bill, the Commission will receive and consider nominations for parcels of state land to be leased for drilling. The bill lays out aspects that the Commission 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 Commission must adopt (see the LSC bill analysis for further information on these requirements). The bill requires the Department of Natural Resources (DNR) to provide clerical, technical, legal, and other support to the Commission. These costs would be paid for out of the newly created Oil and Gas Leasing Commission Administration Fund. However, as the bill does not explicitly provide for start-up costs related to the Commission before any lease revenues are deposited into the new fund, such costs would likely be paid from the Oil and Gas Well Fund (Fund 5180), which is used to fund DNR's responsibilities for regulating oil and gas drilling.

Oil and Gas Leasing Commission Administration Fund

The bill creates the Oil and Gas Leasing Commission Administration Fund to pay for the administrative costs of the Commission, including the expenses incurred by the members. The fund is to be capitalized by fees charged for the nomination of parcels of land to be leased for oil and gas exploration and production, and bid fees charged to persons who submit bids for the lease of state lands. The amounts of these fees will be set by the Commission in administrative rules.

Funds to collect lease and royalty revenues

State Land Royalty Fund

The bill creates the State Land Royalty Fund in the state treasury to receive signing fees, lease proceeds, and royalties collected from oil and gas leases on state lands other than those controlled by DNR's landholding divisions. Money would be deposited into the fund on behalf of the state agencies whose land is being leased, and will pay for land acquisition and capital costs of state agencies in proportion to each agency's share of the revenues. Under the bill, the Office of Budget and Management (OBM) will be responsible for the disbursement of money from this fund, subject to approval by the Controlling Board.

Forestry and Parks Mineral Royalties Funds

The bill creates the Forestry Mineral Royalties Fund and the Parks Mineral Royalties Fund as custodial funds outside of the state treasury. These funds will collect signing fees, rentals, and royalty payments for oil and gas leases on the lands owned or controlled by DNR's divisions of Forestry and Parks and Recreation, respectively. Each fund will be used by its respective division to facilitate land acquisition and capital costs on properties administered by that division. Under the bill, these funds will be under the control of the Director of Natural Resources and, as custodial funds outside the state treasury, will not be subject to appropriation by the General Assembly.

Wildlife Habitat Fund

The bill requires lease payments and royalties from oil and gas leases on lands owned or controlled by the Division of Wildlife to be deposited into the Wildlife Habitat Fund (Fund 81B0). Current law, unchanged by the bill, requires money in the fund to be used to acquire and develop land for the preservation, propagation, and protection of wild animals.

Potential royalty revenues

The bill requires that lease agreements developed under administrative rules contain at least 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 prices, as of March 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.

S.B. 165 of the 128th General Assembly established regulatory cost recovery assessments to replace GRF funding 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.

State land inventory costs

The bill requires state agencies, including state universities, to perform an inventory of all parcels of land under their control and place each parcel in one of four classifications, depending on the presence of certain restrictions that may preclude oil and gas production (see the LSC bill analysis for further details on these classifications). As a result of this requirement, state agencies will incur costs for cataloging their lands, conducting title searches, and collecting information on parcels and their suitability for oil and gas development. This provision would have the most effect on agencies that control large quantities of land such as DNR and the Department of Transportation, as well as institutional agencies, including the Department of Rehabilitation and Correction, the Department of Mental Health, and the Department of Developmental Disabilities. State universities that have substantial land holdings will also incur more of these costs.

Overall, the costs for each agency to conduct an inventory and classify each parcel of land will depend on the extent of an agency's land holdings, the extent to which an agency already maintains an inventory of its lands, and the extent of investigation required to gather enough information to place a parcel into one of the four classifications. The funding source for these costs will also vary by agency, depending on the funds that are used by each for real estate and property management purposes.

The bill also requires DNR to maintain a list of all state-owned lands and their classifications on its web site. This will likely result in additional costs to DNR's Office of Information Technology, depending on the form and functionality of the listing and the technical issues involved. The Office is funded through GRF line item 729321, Office of Information Technology, which was appropriated about $438,000 in FY 2011.

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 responsible for overseeing and regulating oil and gas wells, local fire departments and law enforcement agencies will serve as the first responders to fires and other incidents at wells and storage tank batteries. Although such incidents would be uncommon, their occurrence could result in some additional local costs.

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