Ohio Legislative Service Commission

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Fiscal Note & Local Impact Statement

Bill: Sub. S.B. 165 of the 128th G.A. **Date**: March 31, 2010

Status: As Enacted **Sponsor**: Sen. Niehaus

Local Impact Statement Procedure Required: No — Minimal cost

Contents: Makes various changes to the Oil and Gas Law

State Fiscal Highlights

STATE FUND	FY 2010	FY 2011	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	- 0 -	- 0 -
Expenditures	- 0 -	Potential decrease	Potential decrease
Oil and Gas Well Fund (Fund 5180)			
Revenues	- 0 -	Gain of approximately $2.9 million from new fee collections	Gain from new fee collections
Expenditures	- 0 -	Increase for transitional and start-up costs in the first year of implementation	Continuing additional administrative costs
	- 0 -	Increase of approximately $1.9 million in payroll costs	Increase of approximately $1.9 million in payroll costs
Tax Refund Fund (Fund 4250)			
Revenues	- 0 -	- 0 -	- 0 -
Expenditures	- 0 -	Potential increase to pay assessment refunds	Potential increase to pay assessment refunds

Note: The state fiscal year is July 1 through June 30. For example, FY 2010 is July 1, 2009 – June 30, 2010.

- The bill creates or modifies several oil and gas fees, the proceeds from which would be deposited into the Oil and Gas Well Fund (Fund 5180) used by the Division of Mineral Resources Management within the Department of Natural Resources (DNR) to operate the oil and gas program. These fees could generate revenue of approximately $2.9 million over current levels in their first year of collection, with possible further gains in future years.
- The bill increases the Division of Mineral Resources Management's regulatory responsibilities. As a result, the Division will need to hire additional staff. These added payroll costs are estimated to be $1.9 million annually and would be paid from Fund 5180.

- The added revenue deposited into Fund 5180 will reduce the Division of Mineral Resource Management's reliance on the GRF to fund various administrative costs for the oil and gas program.
- The Division would incur a significant increase in administrative expenses in the first year of the bill's enactment for start-up costs and other necessary implementation actions, with ongoing costs thereafter.
- DNR anticipates hiring 33 new staff members in the Division of Mineral Resources Management, resulting in approximately $1.9 million in additional annual payroll costs.
- The Tax Refund Fund (Fund 4250) in the Department of Taxation could incur additional expenditures to refund illegally or erroneously collected regulatory cost recovery assessments.

Local Fiscal Highlights

- The bill requires that liens, and the cancellation of liens, imposed on oil and gas properties by the Division of Mineral Resources Management be filed with the applicable county recorder, which may result in a minimal gain in recordation fees.
- The bill requires penalties paid for violations of Oil and Gas Law compliance agreements to be deposited into the treasury of the county in which the violation took place.
- County courts of common pleas could incur minimal additional costs to handle appeals of enforcement actions taken by the Division of Mineral Resources Management under the bill.
- Local political subdivisions could incur some additional minimal costs to hold public meetings regarding proposed oil and gas development in urbanized areas as required by the bill.

Detailed Fiscal Analysis

Overview of the bill

The bill makes a variety of changes to the Oil and Gas Law that affect the Department of Natural Resources (DNR) and the Division of Mineral Resources Management (DMRM) in particular. The most significant provisions of the bill relate to new fees and changes to existing fees established in statute. The bill also contains many provisions altering administrative procedures dealing with regulatory oversight of the oil and gas industry. The provisions of the bill with fiscal effect are described below.

Oil and gas fees

DMRM currently collects most of its revenue from a combination of regulatory and administrative fees and severance taxes on the extraction of mineral resources, with a portion of the Division's budget consisting of GRF funds. Severance taxes are levied on oil and natural gas, as well as coal and other mineral deposits. DMRM's oil and gas programs are funded by oil and gas severance taxes and fees charged for drilling permits and plugging abandoned wells, which are deposited into the Oil and Gas Well Fund (Fund 5180), as well as an allocation from the Division's GRF line item. The new fees and changes to existing fees proposed in the bill are intended to reduce the Division's reliance on the GRF and provide a dedicated source of funding for oil and gas regulatory and administrative activities. Table 1 below shows a list of all proposed new fees or fee modifications in the bill, as well as DNR's estimates of the revenue expected to be generated by each, if known.

Based on the revenue estimates in the table below, the new fees and adjusted rates would yield $2.9 million in additional revenue during the first full year of implementation, and possibly more, depending on the revenue received from the three fees for which revenue estimates are currently unavailable. To provide a comparison, total receipts from the existing fees in FY 2009 were just under $3.0 million. Ultimately, however, the revenue gained from these new and adjusted fees depends on the level of oil and gas industry activity in Ohio.

Table 1. New and Modified Fees in S.B. 165			
Fee	**Current Rate**	**S.B. 165 Rate**	**Estimated New Revenue**
Regulatory cost recovery assessment – oil	N/A	$0.10/barrel	$495,641
Regulatory cost recovery assessment – gas	N/A	$0.005/thousand cubic feet	$395,995
Regulatory cost recovery assessment – new exempt domestic wells	N/A	$60/well	Unknown gain
Injection well disposal fee – in-district	N/A	$0.05/barrel	$275,000
Injection well disposal fee – out-of-district	N/A	$0.20/barrel	$300,000
Gas storage well regulatory fee	N/A	$125/well	$220,000
Mandatory pooling fee	N/A	$5,000/well	$75,000
Temporary inactive well fee – new	N/A	$100/well	$500,000
Temporary inactive well fee – first renewal	N/A	$250/well	
Temporary inactive well fee – subsequent renewal	N/A	$500/well	
Well transfer fee	N/A	$100/well	$350,000
New well drilling permit fee – townships w/population fewer than 5,000	$250/well	$500/well	$150,000
Expedited review fee – new wells not in gas reservoir area	$500/well	$250/well	Unknown loss
Well plugging permit fee	$50/well	$250/well	$160,000
Expedited review fee – well plugging	$250/well	$500/well	Unknown gain
Brine injection permit fee	$100/well	$1,000/well	Unknown gain
Total – all fees with known revenue estimates			**$2,921,636**

New fees

The bill creates several new fees that must be paid by well owners or operators in order to carry out certain activities or obtain certain services. These new fees, like current oil and gas severance taxes and existing oil and gas fees, would be credited to Fund 5180, which supports DMRM's oil and gas operations. These new fees and their purposes are summarized below.

Regulatory cost recovery assessment. Currently, well operators pay a severance tax of 10 cents per barrel of oil or 2.5 cents per thousand cubic feet of natural gas produced by a well. Under the bill, DMRM would charge an additional 10 cents per barrel of oil and one-half cent per thousand cubic feet of natural gas as a regulatory cost recovery assessment to be collected quarterly, alongside and generally in the same

manner as the severance tax. The minimum amount of a quarterly assessment must be the greater of either (1) $15 times the number of an owner's wells, or (2) the amount of an owner's severance taxes plus the regulatory cost recovery assessment imposed by the bill.

The bill creates an exception to the above assessments for an exempt domestic well, which is a well that is primarily used for domestic purposes by the well's owner. The bill creates a new assessment of $60 for each well that becomes an exempt domestic well on and after the effective date of the bill. Exempt domestic wells in existence prior to the bill's enactment would not be subject to this assessment. For all other exempt wells, the bill requires owners to pay this assessment to DMRM annually rather than quarterly, on July 1 of each year.

In general, the bill applies these new assessments to the same statutory requirements that currently exist for the oil and gas severance taxes. In particular, the bill requires the Tax Commissioner to refund assessments illegally or erroneously collected from the Tax Refund Fund (Fund 4250), which is also used to pay refunds for other taxes, including the severance tax. The bill also authorizes the Tax Commissioner to enforce collection of the regulatory cost recovery assessment and to impose assessments against persons who fail to pay them. The punitive assessments would be deposited into the Oil and Gas Well Fund (Fund 5180).

Injection well disposal fee. The bill creates a per-barrel fee on substances that are delivered for the purpose of being injected into a well. The fee is 5 cents per barrel when the substance is produced within the same DMRM regulatory district as the well or in an adjoining district, and 20 cents per barrel when the substance is produced outside of such an area. These fees apply to a maximum of 500,000 barrels of a substance per well per year; any barrels over that amount are not subject to the fee. The bill specifies that injection well owners may retain up to 3% of the fee and forward the remainder to the Treasurer of State for transmission to DMRM for the administration of injection well statutes.

Gas storage well regulatory fee. The bill requires the owner of a gas storage well or a gas storage reservoir monitoring well to pay an annual fee of $125 per well to fund DMRM's gas well storage program and related regulatory oversight functions, including inspections. Under the bill, an owner must pay the fee by March 31 of each year, and the proceeds of the fee would be deposited into Fund 5180. According to DNR, approximately 1,760 wells would be subject to this fee.

Mandatory pooling fee. The bill creates a fee of $5,000 to be added to standard application fees for permits to drill a well if the application is for a permit that requires mandatory pooling. According to DNR, only about 15 wells would be subject to this fee.

Temporary inactive well fee. The bill creates a "temporary inactive well status" for wells that **have annual production** of less than a certain amount of oil or gas. The bill creates a fee of $100 per well to be paid upon first applying for a one-year

temporary inactive well status. The fee for a first renewal would be $250 per well, and each subsequent renewal would be $500 per well. DNR estimates that approximately 1,000 wells would qualify for temporary inactive well status and be subject to this fee.

Well transfer fee. The bill creates a fee of $100 per well to be paid (1) upon the assignment or transfer of the entire interest in an oil or gas lease, or (2) the transfer of the entire interest of a well to a landowner for use as an exempt domestic well. DNR estimates that approximately 3,500 wells would be subject to this fee.

Changes to existing fees

The bill increases the rates of four fees, and decreases one fee, that oil and gas producers currently pay to DMRM. The bill increases the fees for small township well drilling permits, well plugging permits, expedited review of permit applications to plug and abandon a well, and brine injections, and decreases the fee for expedited review of certain permit applications to drill a new well. Income from the fees is deposited into Fund 5180, as would be any additional revenue from the increases proposed in the bill. These proposed modifications are:

Well drilling permit fee. Under current law, there is a fee of $250 for a permit to drill an oil or gas well in a township with a population of fewer than 5,000 residents, and a fee of $500 for a permit to drill in a township with at least 5,000 but fewer than 10,000 residents. The bill consolidates these into a single fee of $500 for drilling in townships with populations of fewer than 10,000. This change would only affect applicants for permits to drill in townships with fewer than 5,000 residents. DNR estimates that approximately 600 wells would be subject to this fee.

Expedited review fee – new wells in nongas reservoir areas. Under current law, there is a fee of $500 for an expedited review of an application for a permit to drill a new well, if the well is not to be located in a gas storage reservoir or reservoir protective area. The bill *decreases* this fee to $250.

Well plugging permit fee. Under current law, there is a fee of $50 to apply for a permit to plug and abandon a well if the well has produced oil or gas. The bill increases this fee to $250. Revenue from this fee increase would be used to address the backlog of idle and orphaned wells that have not yet been plugged. DNR estimates that this fee would apply to approximately 800 wells. According to the Department, the average cost to plug a well is between $8,000 and $12,000, though some wells may cost as much as $20,000 to plug.

Expedited review fee – well plugging. Under current law, unless the Chief of DMRM has ordered a well to be plugged, there is a fee of $250 to apply for an expedited review of an application to plug and abandon a well. The bill increases the fee from $250 to $500.

Brine injection fee. Under current law, there is a fee of $100 for a permit to inject brine or other waste substances into an underground formation unless the Chief of DMRM expressly authorizes the injection. The bill increases this fee to $1,000.

Administrative provisions

Purpose of the Oil and Gas Well Fund (Fund 5180)

Current law requires that money in the Oil and Gas Well Fund (Fund 5180) be used to (1) plug wells and properly restore land surfaces for which bonds have been forfeited, (2) plug abandoned wells for which no funds are available, (3) inject oil or gas production wastes in abandoned wells, (4) correct conditions that the Chief of DMRM reasonably determines are causing imminent health or safety risks, and (5) administer the Natural Gas Policy Act of 1978 and the Division's other functions. The bill revises the uses of the money in Fund 5180 to require that at least 14% of the revenue credited to the fund during the previous fiscal year be used solely and exclusively for the purposes described below.

Well plugging, surface restoration, and injection

The bill generally maintains the requirements in (1) and (3) above, but specifies that wells to be plugged are "idle and orphaned wells," removes item (2), and no longer requires that the fund be used for land surface restoration for which bonds have been forfeited. The bill further specifies activities that may be performed under contracts for well plugging or land restoration, and expressly prohibits the use of expenditures from the fund for contractor salaries, maintenance, equipment, or other administrative purposes except for costs directly attributed to plugging idle and orphaned wells.

In addition, under current law, a landowner who has not properly plugged and abandoned a well or has not properly restored the land may be reimbursed by DMRM for the reasonable costs of doing so under certain conditions. The bill generally maintains this authorization, but requires that DMRM's expenditures be consistent with the bill's new requirements for well plugging and land restoration contracts as described above.

Correction of health and safety risks

The bill adds the requirement that the imminent health and safety risks included in requirement (4) above be located at an idle or orphaned well. The bill authorizes money in Fund 5180 to be used to initiate a corrective action on a well for which the owner cannot be contacted, and requires DMRM to issue an order requiring the well owner to reimburse the Division for the actual documented costs of such an action.

Administration

The bill adds that expenditures from Fund 5180 must be used solely and exclusively for the administration of the Oil and Gas Law and the Underground Storage of Gas Law (encompassing the requirements described above), including for purposes that are critical and necessary for the protection of human health and safety and the environment related to oil and gas production in the state. The bill additionally prohibits money in the fund from being used for the purchase of real property or to remove a dwelling in order to access a well.

Additional expenses related to new requirements

The bill makes a number of changes to various parts of the Oil and Gas Law that DMRM will be required to implement and enforce. The LSC bill analysis contains more detailed descriptions of these provisions. Briefly, these include:

- Changes to the terms and conditions of an oil or gas permit;
- Changes to mandatory pooling requirements;
- Changes to required setback distances for oil and gas wells and tank batteries in urbanized areas;
- New notification requirements for permittees, local governments, and landlords;
- New requirements for conducting well stimulation activities;
- A new procedure for designating wells as temporarily inactive (see above for a description of the temporary inactive well status fee);
- Modified requirements for well construction;
- Modified requirements for filing statements of production and wireline electric well logs;
- Modified requirements for determining the suitability of a well for plugging;
- Modified requirements for conducting secondary or additional recovery operations;
- Modified requirements for the storage, disposal, or injection of brine and other waste substances;
- Modified requirements for administrative rulemaking regarding oil and gas drilling, production, and plugging;
- Modified requirements for land surface restoration;
- New authority for DMRM to enforce provisions of the Oil and Gas Law;
- Modified requirements for well owner liability insurance coverage;
- Modified permitting requirements for plugging and abandoning a well;
- Modified requirements for assigning or transferring wells and leases; and
- New requirements related to the transportation and application of brine;
- A new requirement that the Division maintain an online, publicly accessible database of final, nonappealable orders and material and substantial violations.

Overall, the Division of Mineral Resources Management will incur substantial new costs for implementing the changes required by the bill. Although these costs would largely be borne by Fund 5180, some of these initial expenses could be paid from the GRF until sufficient revenue from the new fee structure has accrued. In FY 2009, DMRM spent approximately $2.9 million on oil and gas regulation, including $2.7 million (92.4%) from Fund 5180 and $220,266 (7.6%) from the GRF.

Appropriations for oil and gas operations under H.B. 1 currently total approximately $6.6 million in FY 2010 and $4.8 million in FY 2011, as shown in Table 2 below. Note that while both line items in Fund 5180 are used exclusively for DMRM's oil and gas programs, only a portion of the GRF funding is used for these purposes. However, DMRM is relying on an increased portion of GRF line item 744321, Division of Mineral Resources Management, to fund oil and gas operations in FY 2010. In this fiscal year to date, $390,463 has been spent from line item 744321 for oil and gas programs, approximately 77.3% above the total amount spent in FY 2009.

Table 2. Appropriations for Oil and Gas Programs, FY 2010-FY 2011

Fund	Line Item	FY 2010	FY 2011
GRF	744321, Division of Mineral Resources Management*	$2,800,000	$1,000,000
5180	725643, Oil and Gas Permit Fees	$2,974,378	$2,974,378
5180	725677, Oil and Gas Well Plugging	$800,000	$800,000
	Total	**$6,574,378**	**$4,774,378**

* Funds in this line item also support DMRM activities not related to oil and gas.

Foremost among the new costs the Department would incur in administering the revisions to the oil and gas programs are those for payroll. Currently, DMRM employs 35 full-time equivalent (FTE) employees in its oil and gas programs. Under the bill, the Division anticipates that it would need to hire at least another 33 FTEs, bringing the total to at least 68 FTEs in these two programs. These new positions would be in the areas of field inspection, permitting, administration, and information technology. The additional information technology staff would be needed to implement the required online violations database and perform mapping operations.

Personnel costs (including salaries and fringe benefits) incurred by the oil and gas program totaled slightly over $2.0 million in FY 2009. Of this amount, 3.7% was paid out of the GRF, while 96.3% was supported by Fund 5180. However, the GRF has assumed a larger portion of oil and gas payroll costs incurred to date in FY 2010. Total FY 2010 payroll costs to date for the oil and gas program have been approximately $2.1 million, of which $1.3 million (63.8%) was derived from Fund 5180 and $748,000 (36.2%) came from the GRF.

Using FY 2009 payroll expenditures of $2.0 million for a staff of 35 employees, this represents an average payroll cost of just over $57,000 per employee, including wages and fringe benefits. At the same average pay rate, an additional 33 employees would cost the Division an additional $1.9 million annually, not taking into account variable costs such as regular step increases and other adjustments. Presumably, all of this additional payroll would be paid out of Fund 5180 rather than the GRF, supported in large part by the new and increased fees proposed in the bill.

Fiscal effect – local governments

Administration/enforcement

Some of the provisions listed above would have an effect on local governments, particularly those related to enforcement of the Oil and Gas Law. Current law allows well owners to appeal certain actions by the Chief of DMRM to the court of common pleas in the applicable county. The bill's modification to some of these requirements may result in additional appeals and thus additional costs to county courts to handle the cases, though these are not likely to be more than minimal. These expenses may be offset by a provision requiring penalties associated with violations of a compliance agreement entered into under the Oil and Gas Law to be paid into the treasury of the county in which the violation occurred.

Public meetings

The bill requires the legislative authorities of political subdivisions to hold public meetings concerning proposed lease agreements for oil and gas development on land that is (1) located in an urbanized area and (2) owned by the political subdivision. This requirement and its attendant notification requirements may create additional minimal costs to local governments.

Other provisions

Surety bonds

The bill makes some changes to current law and institutes new provisions regarding the circumstances under which an oil and gas producer must provide a surety bond to DMRM. Under current law, a producer must file a surety bond with DMRM before being issued a permit for a well. The bill adds that a bond must be filed before a well is operational and productive, and prohibits the operation of a well if a surety bond has not been filed. The bill also requires any owner, operator, producer, or other person who forfeited a surety bond to post a new bond in the amount of $15,000 for a single well, $30,000 for two wells, or $50,000 for three or more wells. For a well owner who applies more than three times for a renewal of temporary inactive well status, the bill authorizes the Chief of DMRM to require a surety bond in an amount up to $10,000 for each temporary inactive well. Finally, the bill makes changes regarding surety bond requirements for brine transporters. Overall, the changes to surety bond procedures may result in some additional surety bonds being held by the Department and retained in the Bond Refunds Fund (Fund R017).

Priority liens

The bill grants DMRM the authority to impose a priority lien against an owner's interest in an oil or gas well if the owner fails to pay applicable oil or gas fees, or if DMRM incurs costs to correct imminent health and safety risks associated with a well. Any lien would be in the amount of fees owed and costs incurred, and amounts collected pursuant to a lien would be deposited in the Oil and Gas Well Fund (Fund

5180). The bill also specifies that DMRM's priority lien is in addition to any lien imposed by the Attorney General for failure to pay the oil and gas regulatory cost recovery assessment or severance taxes. In cases where the Attorney General cannot collect such a lien, the bill allows the Tax Commissioner to request that DMRM impose a priority lien for assessments and taxes owed. In addition to these changes, the bill requires DMRM to file the following documents in the office of the county recorder in the county in which the well is located: (1) a statement of the lien, (2) any lien modifications, and (3) upon release of the lien, a certificate of release. This could lead to the collection of some minimal additional recordation fees by county recorders.

Natural gas company exemption orders

The bill authorizes the Public Utilities Commission of Ohio (PUCO) to exempt a natural gas company's investment in gathering lines or storage facilities from certain statutes pertaining to PUCO's rate-setting authority and operating requirements. Under the bill, this would allow a natural gas company to bear the financial risk and reward for such a facility and would require the company to separate the operations of the exempted facility from the company's nonexempt operations. The bill grants PUCO continuous jurisdiction to enforce the terms of any exemption order and the authority to alter, amend, or suspend an order under certain conditions. Regardless, a natural gas company issued an exemption under these circumstances would still be required to pay all regulatory taxes and fees under current law. This provision would thus have no fiscal effect on the state.

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