Ohio Legislative Service Commission

Brian Hoffmeister

Fiscal Note & Local Impact Statement

Bill: S.B. 241 of the 128th G.A. **Date**: May 19, 2010

Status: As Introduced **Sponsor**: Sen. Faber

Local Impact Statement Procedure Required: No — Possible indirect local effects

Contents: Authorizes oil and gas development on state-owned lands

State Fiscal Highlights

- The bill creates the Oil and Natural Gas Lease Fund in the Department of Natural Resources (DNR) to collect lease bonus payments and royalties from the production of oil and gas on state-owned lands. The proceeds derived from these sources will depend on several factors dictated by DNR administrative rules and market conditions.
- The bill requires the Oil and Natural Gas Lease Fund to be used to pay the costs of capital improvement projects at state parks.
- The existing Oil and Gas Well Fund (Fund 5180) could collect some additional revenues from severance taxes, permit fees, and other regulatory fees related to wells drilled on state lands.
- The Division of Mineral Resources Management will likely incur additional costs to oversee new oil and gas drilling activity authorized by the bill. These costs would be paid from the Oil and Gas Well Fund (Fund 5180).
- The Division of Parks could also incur new costs that would be covered by GRF line item 730321, Division of Parks and Recreation, and possibly the State Park Fund (Fund 5120).
- State agencies with existing lease agreements for oil and gas development would presumably forgo revenue from any future leases the state enters into on their behalf after the bill's effective date.

Local Fiscal Highlights

- Local governments in areas where state lands are leased for drilling may incur certain minimal indirect costs related to public safety concerns, such as responding to well or storage tank fires, spills, or other such incidents.

Detailed Fiscal Analysis

Overview

The bill grants the Department of Natural Resources (DNR) the exclusive authority to enter into leases for oil and gas development on lands owned by the state of Ohio and administered by a state agency. The bill establishes a competitive bid process for the awarding of oil and gas leases. Under this process, state agencies would nominate parcels of land they own for possible oil and gas exploration and production. The Director of Natural Resources would be responsible for approving or denying such nominations. If a nomination is approved, interested oil and gas developers would submit competitive bids to obtain a lease on the property. The bill requires that specific procedures and guidelines for the nomination and bidding processes, including amounts of lease annual payments and lease bonus payments, be established in administrative rules. These provisions are described in further detail below.

Oil and Natural Gas Lease Fund

The bill creates the Oil and Natural Gas Lease Fund and requires money in the fund to be used to pay for capital projects and improvements at Ohio's state parks. The fund is to consist of two primary sources of revenue: lease annual payments and lease bonus payments, commonly known as "bonus bids." Under the bill, a lease annual payment is the state's share of the annual royalties from oil or natural gas produced from a well on state lands. A lease bonus payment is the amount an oil or gas producer pays to the state upon being awarded a lease. Lease annual payments depend on the amount of oil or gas produced from wells under a lease agreement, whereas bonus bids are paid to the state up front regardless of whether oil or gas is ever produced from a leased parcel.

Revenues from expanded oil and gas development on state-owned land would depend on a variety of factors, including:

1. The cost for DNR to obtain the mineral rights on lands for which the state does not already own them;
2. The amount of acreage opened up for drilling;
3. The rental rates established for private entities to conduct oil and gas drilling activities on state-owned lands, to be determined by administrative rules promulgated by DNR;
4. The amounts of the bonus bids received from prospective oil and gas lessees;
5. The viability of drilling given market conditions and oil and natural gas prices;
6. The number of wells drilled; and
7. The amount of oil and gas production for each active well.

In its report issued in February of 2009, the Ohio State Park and Recreational Area Study Committee estimated that oil and gas reserves on state park and state forest lands could generate between $3 million and $5 million annually based on market conditions at the time. These amounts are based on the estimated developable land where oil and gas reserves may be present. However, these amounts are based only on state park and state forest lands held by DNR, and assume that all developable areas on these lands would be productive in the short term.

Royalties and bonus bids would not be the only source of additional revenue under the bill. Oil and gas producers would be subject to the same permitting requirements as under current law, and would still be required to pay severance taxes on oil and gas production. Income from permit fees, cost recovery assessments, and other regulatory fees, as well as severance taxes, would be deposited into the Oil and Gas Well Fund (Fund 5180), which is used to support the oil and gas regulatory functions in the Division of Mineral Resources Management (DMRM).

In addition, it should be noted that while bonus bids and permit fees would be collected in fairly short order under the bill, income from royalties and severance taxes would depend on how quickly production begins on leased lands. Initial revenues would likely grow over time until peak production is reached, after which there would be some decline as the reserves on state lands are depleted.

Agencies already leasing lands

Under current law, some state agencies already maintain lease agreements with operators for oil and gas development on public lands, including acreage belonging to state institutions of higher education. These state agencies include the Ohio Department of Transportation (ODOT) and the Department of Administrative Services (DAS). ODOT permits leases of its right-of-way if such leases would complete an adjacent drilling unit and would not compromise highway integrity. DAS has broader responsibility, entering into leases on behalf of other departments such as the Department of Mental Health and institutions of higher education.

Currently, ODOT has 290 active leases for oil and gas drilling on its land, averaging between three and five acres per lease. ODOT keeps a share of any royalties from oil or gas produced on a drilling unit that includes ODOT land. These are deposited into the Highway Operating Fund (Fund 7002) and are used for highway projects along with other money in the fund. ODOT's income from oil and gas leases over the past three calendar years has been between approximately $200,000 and $360,000. DAS currently has 15 oil and gas leases under its authority, totaling just under 624 acres, mostly on land owned by universities. In the case of DAS, royalties are kept by the agency or institution on whose behalf DAS has entered into a lease.

Under the bill, all authority to enter into oil and gas leases on state-owned lands would fall to DNR, and all revenues from such leases would be deposited into the newly created Oil and Natural Gas Lease Fund. Thus, any revenues realized by another state agency on whose lands wells are drilled would be forgone by that agency and

instead remitted to DNR. However, presumably DNR's new exclusive authority would apply only to new wells started after the bill's effective date, and agencies with existing leases at that time would still collect royalties under the terms of those leases until the lease agreements are amended or expire.

Administrative costs

The bill requires DNR to establish administrative rules governing the procedures for authorizing new oil and gas leases on state lands. These rules are to cover nominations and submissions of bids for drilling on state lands; the terms and conditions of leases; the amounts of lease payments; the creation of scenic, aesthetic, and environmental standards for lands on which drilling takes place; and other administrative measures. Together, these provisions will likely add new administrative costs for DMRM and the Division of Parks. DMRM would continue to act in its capacity as the permitting agent and regulatory authority responsible for overseeing new oil and gas wells, while the Division of Parks would likely be responsible for aspects dealing with real estate and land management, such as entering into leases. The Division of Parks will also administer the Oil and Natural Gas Lease Fund, which is to be used for capital projects in the state park system.

Any additional administrative costs to DMRM would likely be borne by the Oil and Gas Well Fund (Fund 5180), which is funded by severance taxes, permit fees, and other regulatory fees on oil and gas operations. Administrative costs to the Division of Parks would likely be borne by GRF line item 730321, Division of Parks and Recreation, which funds most central administrative operations of the Division of Parks, including real estate. Some costs could also be paid from the State Park Fund (Fund 5120), which is supported by various operating revenues of the state parks, such as camping fees, concessions, rental fees, and other such sources.

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 could result in some minimal local costs.

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