LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 79TH LEGISLATIVE REGULAR SESSION

May 29, 2005

TO: Honorable David Dewhurst , Lieutenant Governor, Senate
Honorable Tom Craddick, Speaker of the House, House of Representatives

FROM: John S. O'Brien, Deputy Director, Legislative Budget Board

IN RE: **HB2161** by West, George "Buddy" (Relating to the power of the Railroad Commission of Texas to adopt and enforce safety standards and practices applicable to the transportation by pipeline of certain substances and to certain pipeline facilities, the provision of severance tax credits and exemptions and other incentives and procedures for producing oil or gas from certain wells or plugging wells, and the procedure for computing severance taxes in connection with certain gas sales; imposing an administrative penalty.), **Conference Committee Report**

Estimated Two-year Net Impact to General Revenue Related Funds for HB2161, Conference Committee Report: a positive impact of $27,916 through the biennium ending August 31, 2007.

The bill would make no appropriation but could provide the legal basis for an appropriation of funds to implement the provisions of the bill.

General Revenue-Related Funds, Five-Year Impact:

Fiscal Year	Probable Net Positive/(Negative) Impact to General Revenue Related Funds
2006	$2,303
2007	$25,613
2008	$0
2009	$0
2010	$0

All Funds, Five-Year Impact:

Fiscal Year	Probable Revenue Gain/(Loss) from *GENERAL REVENUE FUND* 1	Probable (Cost) from *GENERAL REVENUE FUND* 1	Probable Savings/(Cost) from *OIL-FIELD CLEANUP ACCT* 145	Probable Revenue Gain/(Loss) from *OIL-FIELD CLEANUP ACCT* 145
2006	$88,000	($85,697)	($740,000)	$0
2007	$88,000	($62,387)	($740,000)	$0
2008	$0	$0	($240,000)	$0
2009	$0	$0	($240,000)	$0
2010	$0	$0	($240,000)	$0

Fiscal Analysis

The bill would provide authority to the Railroad Commission (RRC) to prescribe or adopt safety standards relating to the prevention of damage to pipeline facilities resulting from the movement of earth by a person in the vicinity of such pipeline facilities. That authority would not apply to surface mining operations or to operations the Railroad Commission would determine should be exempt until September 1, 2008. The regulations over earth movement could not take effect until September 1, 2007.

The bill would amend various sections of the Natural Resources Code and the Tax Code to create an incentive program administered by RRC for orphaned oil and gas or service wells adopted by an operator in good-standing to adopt orphaned wells. An orphaned well would be defined as a well issued a permit by RRC with no reported production or activity for the preceding twelve months and whose designated operator's organization report had lapsed. A person considering operatorship could nominate an orphaned well to conduct a surface inspection to determine whether the person desired to be designated as the operator of the well. The bill would establish criteria for notifying the owner of the surface estate and any occupants of the tract, and it would set guidelines for the inspection.
A person designated by RRC as an operator of an orphaned well would be entitled to a non-transferable crude oil and natural gas severance tax exemption for all future production from the orphaned well. The operator would also be entitled to a payment of 50 cents per foot of well depth if the operator plugged the well or brought the well back into continuous service, defined as a well producing 10 barrels of oil or 100 mcf of gas for at least three consecutive months. The bill would limit the annual payments, which would be drawn from GR Account 0145—Oil-Field Cleanup, made by RRC under this provision to $500,000 per fiscal year.

If an orphaned well were plugged by the surface owner, RRC would reimburse the owner for the plugging costs from GR-Dedicated Account No.145 in an amount not to exceed 50 percent of the lesser of actual costs or the average cost incurred by RRC in the preceding 24 months in plugging similar wells. RRC could not designate an operator for the purposes of the orphaned well program after December 31, 2007. RRC would collect a $250 nonrefundable fee to be deposited to the General Revenue Fund and appropriated to RRC to enforce conservation and pollution laws.

The bill would provide civil penalties for filing a false application with RRC for the purpose of receiving a tax exemption. The bill would provide the Attorney General authority to recover a penalty, and the venue for such suit would be Travis County. The orphaned well program would take effect January 1, 2006.

The bill would amend Chapters 201 and 202 of the Tax Code to provide three levels of tax credits for oil and gas production from qualified low-producing oil leases and gas wells for any given month, depending on Comptroller's average taxable oil and gas prices, adjusted to 2005 dollars, based on applicable price indices of the previous three months. An operator of a qualifying low-producing gas well would be entitled to a 25 percent tax credit if the average taxable gas price were more than $3.00 per mcf but not more than $3.50. The tax credit would increase to 50 percent if the price were more than $2.50 per mcf but not more than $3.00, and 100 percent if the price were $2.50 or less. An operator of a qualifying low-producing oil lease would be entitled to a 25 percent tax credit if the average taxable oil price were above $25 per barrel but not more than $30. The tax credit would increase to 50 percent if the price were above $22 per barrel but not more than $25, and to 100 percent if the price were $22 or less. These provisions would expire on September 1, 2007.

The bill would define a qualifying low-producing gas well as a well that averaged, over a three-month period, 90 mcf per day or less. The bill would define a qualifying low-producing oil lease as a lease that averaged, over a 90-day period, less than 15 barrels per day per well or 5 percent recoverable oil per barrel of produced water per well.

The bill would require a $100 filing fee for oil leases qualified under the 5 percent recoverable oil requirement. The fee would be collected by the Comptroller's Office. The bill would limit tax credits only to wells currently paying full tax rates. (As such, it would exclude those wells operating under existing tax incentive programs.) The bill would not extend tax credits to casinghead gas and condensate production.

The Comptroller's Office would certify and publish in the Texas Register, each month, the average taxable prices of oil and gas, adjusted to 2005 dollars, using applicable price indices during the previous three months. Taxpayers would have to apply to the Comptroller's Office for tax credits within the statutory time limit under Section 111.104. The tax credits would only apply to crude oil and gas produced on or after September 1, 2005.

The bill would create a new oil production tax credit incentive program under Section 202.060 of the Tax Code for taxpayers who use enhanced efficiency equipment in the production of oil.
The bill would define enhanced efficiency equipment as equipment used in the production of oil that reduces the energy used to produce a barrel of fluid by 10 percent or more when compared to commonly available equipment. The definition would specifically exclude motors or downhole pumps.
To qualify for the credit, the equipment would have to be evaluated—and the energy reduction verified—by a Texas institution of higher education, approved by the Comptroller, with an accredited petroleum-engineering program.

The bill would provide a crude oil severance tax credit of up to 20 percent of the cost of the equipment, but not to exceed $2,000 per well. A taxpayer would be allowed to carry a tax credit forward until fully redeemed.

The bill would require that the equipment be purchased and installed on or after September 1, 2005 and on or before September 1, 2009. It would require a taxpayer to file an application with the Comptroller's Office with proof of purchase, installation, and efficiency savings. The bill would limit the number of Comptroller-approved applications per state fiscal year to 2 percent of the producing oil wells on September 1 of that fiscal year. The taxpayer could carry any unused tax credit forward until the credit was exhausted. This program would take effect September 1, 2005.

Methodology

Although the Railroad Commission expects that the provisions of the bill providing authority to the Railroad Commission to prescribe or adopt safety standards relating to the prevention of damage to pipeline facilities resulting from the movement of earth by a person in the vicinity of such pipeline facilities could increase agency inspections, investigations, and complaint workload, it is not expected to be significant to the agency's overall budget.

This estimate assumes that the price thresholds for low-producing well and low-producing credits would not be met during the 2006-07 biennium; therefore, no significant revenue loss is expected as a result of these provisions. However, if the price of oil would fall below $30 per barrel or the price of gas would fall below $3.50 per mfc, a significant revenue loss could occur to the General Revenue Fund and to the Foundation School Fund. Since the bill's provisions relating to the low-producing well and lease credits expire on September 1, 2007, there would be no loss in revenue beyond fiscal year 2007.

To determine which wells qualify as low-producing for incentive purposes created by the bill, the Railroad Commission expects that it would have to begin to collect data on each individual well in the state, which the agency reports would require one-time computer programming at a cost of $3.7 million. However, since this estimate assumes that the price thresholds for low-producing well and lease credits would not be met, it is not expected that the Railroad Commission would need to collect data on individual wells; therefore, no significant fiscal impact to the Railroad Commission is expected as a result of the low-producing credit provisions. If the price thresholds were met, this estimate assumes that the RRC could use existing data its collect with minor modifications, so that information necessary to determine which wells would qualify for incentives could be obtained without a significant cost to the RRC.

The Comptroller's Office indicated there would be administrative and personnel costs to the implementation of the bill; however, this estimate does not expect those costs to be significant.

The Railroad Commission expects a gain to the General Revenue Fund of $88,000 in fiscal years 2006 and 2007 as a result of the $250 fee to adopt an orphaned well. A slightly lower amount for agency administrative costs are included as costs to the General Revenue Fund.

With respect to costs from the Oil Field Cleanup Account No. 145, $500,000 of this amount in fiscal year 2006 and fiscal year 2007 is for payments to operators adopting wells and then plugging them or putting them back into service. An additional $240,000 cost per year out of the Oil Field Cleanup Account No. 145 in each fiscal year through 2010 is attributable to the provisions of the bill relating to reimbursing operators for plugging wells on their own land, assuming 100 such owners would use the program each year at an average well plugging cost of $4,800.

Local Government Impact

No significant fiscal implication to units of local government is anticipated.

Source Agencies: 304 Comptroller of Public Accounts, 455 Railroad Commission

LBB Staff: JOB, WK, ZS, TL, CT