HOUSE RESEARCH ORGANIZATION bill analysis 5/25/99

SB 1731
Brown
(Hawley)

SUBJECT:	Reduced-royalty periods for marginal oil and gas wells on state lands
COMMITTEE:	Energy Resources — favorable, without amendment
VOTE:	6 ayes — R. Lewis, Hawley, Crabb, Merritt, Williams, Woolley 0 nays 3 absent — Driver, West, Wilson
SENATE VOTE:	On final passage, Local and Uncontested Calendar, April 19 — 30-0
WITNESSES:	*(On House companion bill, HB 2449:)* For — None Against — None On — David Dewhurst, General Land Office

BACKGROUND: Most marginally producing oil and gas wells on state lands are subject to royalty rates ranging from 12.5 percent to 25 percent. Natural Resources Code, sec. 32.067 allows royalty rates to be reduced to 6.25 percent for wells producing up to 15 barrels a day onshore or producing up to 50 barrels a day offshore. Royalty reductions are for two-year periods that can be extended for additional two-year periods, upon approval of the School Land Board.

The three-member School Land Board includes the commissioner of the General Land Office (GLO), a gubernatorial appointee, and an appointee of the Attorney General's Office. The board administers all state-owned properties and leases mineral rights on certain state-owned lands, including Permanent School Fund lands.

DIGEST: SB 1731 would allow the School Land Board to prescribe the length of time for which marginally producing oil and gas wells on state lands would be eligible for a reduced royalty rate. The bill would delete the current provision limiting such reduced royalty rates to two-year terms that can be extended for additional two-year periods.

The bill would take effect September 1, 1999.

SUPPORTERS SAY:

SB 1731 would encourage well operators not to plug or abandon marginally producing oil and gas wells on state lands. Plugging or abandonment of these wells results in a loss of revenue to the Permanent School Fund, loss of severance and ad valorem taxes, and loss of jobs for oilfield workers.

The bill would allow the School Land Board to decide the period for which a reduced royalty rate could continue so that the duration could be tailored to individual projects and reviewed in terms of their possible benefits to the state. Allowing the board to review the merits of each application would postpone the abandonment of many wells and increase the economic viability of others, resulting in additional revenue for the state.

Marginally producing oil and gas wells often are abandoned or plugged because the well operators cannot afford to continue to invest in them. Once such a well is plugged, the state loses the chance of gaining any revenue at all from it, since it is not economically feasible to redrill the well.

To keep these wells producing, operators often must invest significant amounts of money in them. For example, they may need to fracture the well — which involves pumping sand into it at high pressure — to enhance production. Also, a well may start producing a large amount of water, and disposing of the water can be expensive.

Operators of marginal wells would be unlikely to make these kinds of investments unless they could rely on a reduction of royalty rates for more than two years. Increased flexibility on royalty reductions would allow companies to extend the life of marginal wells or to calculate a longer period of time needed to recoup their investment.

Although current law allows the reduced royalty rates to continue as long as the School Land Board grants two-year extensions, companies cannot afford to risk substantial amounts of money without guaranteeing that they can lock in reduced royalty rates for longer periods. The board, whose interest lies in maximizing the amount of money available for the school children of Texas through the Permanent School Fund, would not prescribe overly long periods of time for companies to receive the reduction.

The GLO estimates that there are about 3,600 marginally producing wells on state lands — 2,900 oil wells and 700 gas wells. These wells generate about $50 million in revenue annually, of which $5 million goes to the Permanent School Fund. If these wells were plugged or abandoned, all revenue from them would be lost to the state.

The fiscal note estimates that SB 1731 would result in a positive impact of about $500,000 each year. GLO staff estimates that about 10 percent of these wells are plugged annually, and postponing abandonment of the wells would retain that amount of revenue for the Permanent School Fund.

OPPONENTS SAY:

There is no reason to allow the School Land Board to prescribe how long a royalty rate reduction could last on marginally producing oil and gas wells on state lands. The board already has the power under current law to extend these reductions for as long as it wishes. It is prudent to renew them every two years, however, to allow continued oversight by the state.

It is important for the state, when granting these kinds of breaks for oil and gas companies, to reexamine periodically whether it would still be in the state's interest to continue the royalty reduction. Otherwise, the board could set a 10-year reduced rate, for example, and if a well's production were enhanced, it could start producing far more than originally expected. The state then would lose royalties that should be going to the Permanent School Fund.

OTHER OPPONENTS SAY:

The School Land Board should be allowed to prescribe the amount of time that a marginally producing well could receive a reduction in royalty rates, but the time period should not exceed four years. This would give operators enough time to recoup their investments.