HOUSE RESEARCH ORGANIZATION bill analysis 5/15/95

SB 905
Ellis
(Dutton)

SUBJECT: Reducing royalty rates on marginal oil and gas wells on state land

COMMITTEE: Energy Resources — favorable, with amendments

VOTE: 6 ayes — Holzheauser, West, Dutton, Hawley, Jackson, Torres

0 nays

3 absent — Hirschi, Ramsay, Smithee

SENATE VOTE: On final passage, April 20 — 28-0 (Bivins, Moncrief and Montford present, not voting)

WITNESSES: For — None

Against — None

On — Stroud Kelley, Texas General Land Office

DIGEST: SB 905, as amended, would authorize the School Land Board and Board for Lease of University Fund Lands to reduce royalty rates to not less than one-sixteenth (6.25 percent) for oil reservoirs on state owned oil or gas reservoirs that the board determines are marginal.

The bill would define as marginal those wells that have an average daily per well production of no more than 15 barrels of oil or barrels of oil equivalent (BOE). Gulf of Mexico wells would be considered marginal if their average daily per well production was no more than 50 barrels of oil or BOE. The board could require changes to existing oil unit agreements in order to qualify for a royalty reduction.

Barrel of oil equivalent (BOE) would mean 6 million cubic feet of natural gas for each 42-gallon barrel of crude oil or a volume of gas with a minimum heating value of 6,000 British thermal units (6,000 Mbtu), whichever is greater.

A lease issued under the Relinquishment Act of 1919 would provide for a royalty reduction only if the surface owners, who are the state's agents, reduce their royalty by an equal amount. For such leases the royalty floor could be 1/32 (3.125 percent), reflecting the state's half of a 1/16th floor for the total royalty.

If the oil lease was on a river tract, SB 905 would only allow royalty reduction if the state's royalty was made to match the royalties on adjoining leases controlled by the lessee of the river tract. Royalties on leases on highway tracts could be reduced only if the royalty did not fall below the royalties on adjoining tracts.

Royalties could not be reduced on free royalty reservoirs, which have leases that are neither issued nor approved by the General Land Office and from which the Land Office does not collect a bonus or rental. Such reservoirs have royalties fixed at 1/16th.

The bill would take immediate effect if approved by two thirds of the membership of each house.

SUPPORTERS SAY:

With current oil and gas prices, numerous wells on state-owned lands are economically marginal and are often abandoned when even small production problems occur. Some may become orphan wells and add to environmental problems. The General Land Office estimates that perhaps half the wells producing revenue for the Permanent School Fund produce less than four barrels of oil equivalent per day. When such wells are abandoned or shut-in, they provide no income to the lessee, to the Permanent School Fund (PSF) or to the Permanent University Fund (PUF).

To keep marginal wells producing and economically viable, the boards that manage the PSF and PUF oil reservoirs should have the authority that SB 905 would provide to reduce the royalty rate when such action would extend the economic life of a lease and encourage the recovery of oil and gas that might otherwise be abandoned.

SB 905 would ultimately result in more income to the PSF and PUF because some income, even at a lower royalty rate, is better than no income from a well that has ceased production. The bill would also help operators of marginal wells, primarily smaller independent producers who are the economic backbone of many rural Texas communities. The royalty cuts would be more than compensated for by increases in production, severance taxes and property taxes, and the state would wind up with more money for schools.

OPPONENTS SAY: This is one of a series of bills to provide special breaks to the oil and gas industry that would result in only speculative benefits to state taxpayers. This bill proposes significant cuts in royalty rates paid to the state by producers who, having already drilled their wells, have very few expenses and are still making money even when production is low.

NOTES: The committee amendment would allow the Board for Lease of University Fund Lands to consider applications of new recovery techniques and operating efficiency of a reservoir when deciding whether to grant a royalty rate reduction.