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OIL AND GAS REGULATORY FUND

House Bill 5399 as enrolled Public Act 252 of 1998 Second Analysis (9-3-98)

Sponsor: Rep. Kwame Kilpatrick
**House Committee: Conservation,
Environment and Recreation**
**Senate Committee: Economic
Development, International Trade
and Regulatory Affairs**

THE APPARENT PROBLEM:

Part 615 of the Natural Resources and Environmental Protection Act (NREPA) regulates the operation of oil and gas wells. The act allows the Department of Treasury to assess a fee on oil and gas produced in the state equal to up to one percent of the value of oil and gas. This fee revenue provides the resources for the Department Environmental Quality's (DEQ) Geological Survey Division to carry out the monitoring and enforcement provisions of the act. The current procedure provided in the act requires the Department of Treasury to review the amount of revenue appropriated by the legislature and determine an assessment fee rate at a level that will cover the statewide appropriation. The amount appropriated, divided by the estimated gross cash market value of oil and gas that will be produced in the state in the current fiscal year, determines the percentage rate (to the nearest one-hundredth of one percent) of the assessment fee on oil and gas production that will be used for the next year, until a different fee is determined.

The current method of determining fees works fairly well as long as oil and gas production and prices remain relatively constant or are increasing. However, when production or prices drop, this formula results in a shortfall between actual revenues collected and the appropriation. (The provisions of the act require that surplus revenues be carried forward and deducted from the appropriations for the next year). As a result, in 1995, a decline in production and prices resulted in department layoffs and program cuts. The department estimates that the well oversight program requires approximately \$7 million annually to operate.

Several bills have been introduced during the current legislative session, and have been passed by the House, that would alter the state's regulation of oil and gas wells and issues related to mineral wells. (See HLAS analyses of House Bills 4259, 4260, 4873, 5261, and 5262; and, for amendments concerning mining issues, see HLAS analyses of Public Acts 149 and 154 of 1997). For example, Public Act 149 will increase the fees required for drilling permits and establish operating fees for mineral wells. The fees will be deposited in a new mineral well regulatory fund and used to ensure that the program is self-sustaining. It is proposed that similar legislation be introduced to ensure a stable funding source for the oil and gas well regulatory program.

THE CONTENT OF THE BILL:

The bill would amend Part 615 of the Natural Resources and Environmental Protection Act (NREPA), which regulates oil and gas wells, to establish an oil and gas regulatory fund. The bill would also establish a \$20 regulatory fee for oil and gas wells, and would increase, from \$100 to \$300, the current fee required for a well drilling permit. In addition, the bill would delete the current provision that the proceeds of surveillance fees be credited to the general fund. Under the bill, the proceeds of surveillance fees *and* of regulatory fees would be deposited into the Oil and Gas Regulatory Fund.

Annual Well Regulatory Fee. Under the bill, the owner of a well that was used for injection, withdrawal, or observation related to the storage of natural gas, that had been used for its permitted

House Bill 5399 (9-3-98)

purpose at any time during the twelve consecutive months prior to the date the fee was due, would be subject to a \$20 fee. The fee would be due not more than 30 days after the supervisor notified the owner or operator of the amount due. Fees imposed under this provision would be collected by the supervisor of wells and forwarded to the state treasurer for deposit into the regulatory fund.

Annual Report. Under the bill, a well owner or operator would be required to file an annual report by January 31 of each year, stating the number of wells used for injection, withdrawal, or observation related to the storage of natural gas or liquefied petroleum gas that had been utilized for the permitted purpose during the previous calendar year. The report would have to include a list of wells, identified by permit number, permit name, and gas storage field name.

Surveillance Fee. Currently, a surveillance fee of up to one percent of the gross cash market value of the oil and gas produced in the state is levied by the Revenue Division of the Department of Treasury. The fee is subject to the provisions of Public Act 48 of 1929, which governs the levying of a severance tax upon oil and gas producers. In order to determine the fees for the next 12 months, the Department of Environmental Quality (DEQ) must provide the amount that is appropriated each year for the monitoring, surveillance, enforcement, and administration of Part 615 to the Department of Treasury, which then determines the percentage ratio that the appropriation bears to the total gross cash market value of the oil and gas that will be produced. House Bill 5399 would delete this provision. Instead, under the bill, the fee would be determined annually according to the following:

- For the 1998 calendar year, the fee would be one percent, beginning on the second month after the effective date of the bill.
- Subsequently, if the fund balance was less than \$7 million at the end of a fiscal year, the fee would be one percent of the gross cash market value of the oil and gas produced, or the amount calculated to cause the fund to accumulate to \$7 million at the end of the current fiscal year, whichever was less.
- If the fund balance equaled or exceeded \$7 million at the end of a fiscal year, the fee would be calculated in the same manner as at present, i.e., it would be based on the percentage ratio, to the nearest 1/100 of one percent, that the appropriation bore to the total

gross cash market value of the oil and gas that would be produced.

- An accumulation in the fund in excess of \$7 million at the end of a fiscal year would be deducted from the following year's appropriation for the purpose of computing that year's annual fee.

Oil and Gas Regulatory Fund. The bill would delete the current provision under which the proceeds of surveillance fees are credited to the general fund. Instead, the proceeds would be deposited into the Oil and Gas Regulatory Fund. The following are some of the requirements that would be imposed under the bill:

- Money from the fund could only be expended for monitoring, surveillance, enforcement, and administration of the provisions of Part 615.
- The DEQ would have to submit an annual report to the legislature itemizing the fund's expenditures. The report would have to include, at a minimum, the amount of money received and expended; the number of full-time equivalent positions funded with the money; and the number of on-site inspections conducted by the DEQ and violations identified in enforcing the provisions of Part 615, their locations, and a description of the nature of the violations.

Other. After completing an inspection, the supervisor of wells would be required to notify the well owner or operator of any violation of the provisions of Part 615 that had been identified during the inspection.

MCL 324.61501 et al.

FISCAL IMPLICATIONS:

According to the House Fiscal Agency (HFA), the bill would result in a slight increase in revenues for the state. The HFA estimates that there would be a slight revenue increase in the fiscal year 1997-98 fiscal year, due to the bill's provision that a one percent surveillance fee be imposed approximately thirty days after the effective date of the bill. During the succeeding years, however, the amount collected in surveillance fees each year would cover the amount that would be appropriated to the Department of Environmental Quality's (DEQ) Geological Survey Division from the Oil and Gas Regulatory Fund. The HFA estimates that it would take approximately five years for surplus revenues in the fund to accumulate to \$7 million. (Fiscal year 1996-97 revenues resulted in a \$1.8 million surplus). (3-2-98)

ARGUMENTS:**For:**

The bill would enable the Department of Environmental Quality (DEQ) to maintain an adequate oil and gas regulatory program after years of facing shortfalls when oil and gas production declined or when prices dropped. House Bill 5399 is one of several bills that have been introduced to address concerns regarding oil and gas wells, and is the result of an agreement reached between a consortium of interests, including members of the House Conservation, Environment and Recreation Committee and representatives of the industry. The DEQ's Geological Survey Division estimates that the well oversight program requires approximately \$7 million annually to operate. The bill would ensure that amount was deposited in a newly established Oil and Gas Regulatory Fund. The bill would still require that surveillance fees be tied to annual production and market forces. However, whereas, in past years, lower production or prices resulted in lower fees and funding shortfalls for the department, under the bill, excess revenues from higher fees will be placed in the regulatory fund in good years, and used to make up the difference in poor years.

For:

House Bill 5399 would establish a "user-pay" system for determining oil and gas well surveillance fees that would have a substantial impact on the DEQ's ability to maintain an adequate oil and gas regulatory program. As written, the bill would specify that money collected from surveillance fees on oil and gas production would be deposited into a proposed Oil and Gas Regulatory Fund. At the end of a fiscal year, money accumulated in the fund in excess of \$7 million would not lapse to the general fund. Instead, excess revenues would be allowed to accumulate in the fund until it reached \$7 million. One advantage of this approach would be that those who benefit financially from oil and gas production would be responsible for maintaining the regulatory fund.

Response:

Some have suggested that, if the Oil and Gas Regulatory Fund has an accumulation in excess of \$7 million at the end of the fiscal year, the additional money should be transferred to the Cleanup and Redevelopment Fund. This fund, which finances response activities at Superfund sites, replaced the Environmental Response Fund under the provisions of Public Act 380 of 1996. Public Act 380 also established a Small Business Grants Cleanup Program.

Analyst: R. Young

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.