

2011 SENATE FINANCE AND TAXATION

SB 2363

2011 SENATE STANDING COMMITTEE MINUTES

Senate Finance and Taxation Committee
Lewis and Clark Room, State Capitol

SB 2363
1/31/2011
Job Number 13668

Conference Committee

A. R. Miller

Explanation or reason for introduction of bill/resolution:

Relating to annual determination of stripper well status on an individual well basis under the oil extraction tax

Minutes:

Written Testimony Attached

Chairman Cook opened the hearing on SB 2363.

Senator Taylor – SB 2363 has to do with a section of the oil tax code that deals with stripper wells in North Dakota. Honestly it's not something I had given a lot of thought to, although it's been brought up in prior sessions I know. I had some House members ask me about forwarding this and I was glad to do it. As someone who comes from outside of the oil patch, it is a little bit beyond us, but when we look at the tax code as Senators, we look at where there may or may not be some discrepancies, or if one would call them a loophole, there may be some opportunities here to clean things up a bit. A stripper well as defined in this section, depending on the depth of the well, is any well that is below 10, 20, or 30 barrels per day. When they make that qualification they are exempt from the extraction tax of 6.5%. You still pay the production tax of 5%. What this bill does, it still keeps those definitions, and I think that is a policy decision we have made in the state of North Dakota that those 10, 20, and 30 barrel per day wells probably ought to be exempt from extraction tax, but it does remove the word property so that stripper wells would stand on their own. As it is right now, to my understanding, on a piece of land where there is a stripper well that was at one time defined to have less than 10 to 30 barrels per day, when another well is drilled on that property at the same depth as the stripper well it is automatically a stripper well also and has no extraction tax, just production tax. Spacings have gotten larger in the oil field so you are not looking at 40 and 80 acre spacings anymore, you are looking at 640's, 1280's, so there's more and more room for a well to qualify as a stripper well on that property. So it removes that property definition, and it asks for qualification, an annual certification. As it stands right now, once the well is defined as a stripper, to my knowledge there's not a certification process that will go back in and say is it still at 30 barrels per day? We thought an annual certification by Industrial Commission would not be an onerous thing to do.

Senator Taylor went on to state some statistical numbers.

Representative Onstad – I stand in support of SB 2363. The reason for SB 2363 is it talks about the definitions that we have current for stripper wells and stripper properties and basically specifically stripper properties. I don't think it was the intent when we started having stripper property to be encouraged with what we are seeing now.

Representative Onstad went on to describe the maps he handed out. (attachments A, A1 and A2)

Chairman Cook asked for testimony opposed to SB 2363.

Ron Ness, President, North Dakota Petroleum Council – (see attached testimony B opposed to SB 2363)

Senator Burckhard – Typically how long do the large companies own these wells before they sell them off?

Ron Ness, President, North Dakota Petroleum Council – I think that question is very difficult. It's going to depend upon the field, the number of wells you have, and it's all about the economics. Large companies look for large prizes. Small companies take those assets after they've been devalued, purchase them, and then try to add life to them and add their ability to operate a lower cost, their ability to extend their engineering techniques. They often times try to unitize them and use secondary enhancement recovery methods. Those kinds of things.

Jeff Herman, Petro-Hunt LLC – We operate a number of stripper wells; we bought out Texaco when they left. We bought out Chevron when they left. So we've got a number of old Madison properties that fall in to the stripper classification. We have limped along with those wells for 20-30 years. To be penalized to have a success like Ron said, just doesn't make sense. These wells are very expensive to keep going. They are valuable to the state for the small amount of production that they do have. They don't produce much, and if you can manage to get an increase on a few of them, it helps pay to keep the other one going. So, I would oppose the bill.

Bill Shalhoob, North Dakota Chamber of Commerce – (see attached testimony C opposed to SB 2363)

Chairman Cook asked for neutral testimony for SB 2363.

Lynn D. Helms, Director, Department of Mineral Resources – (see attached testimony D neutral to SB 2363)

No further action was taken.

Chairman Cook closed the hearing on SB 2363.

2011 SENATE STANDING COMMITTEE MINUTES

Senate Finance and Taxation Committee
Lewis and Clark Room, State Capitol

SB 2363
2/7/2011
Job Number 14136

Conference Committee

A. R. Miller

Explanation or reason for introduction of bill/resolution:

Relating to annual determination of stripper well status on an individual well basis under the oil extraction tax

Minutes:

Committee Work

Chairman Cook opened discussion on SB 2363.

Senator Triplett – I asked Mr. Walstad to separate out the 2 issues in this bill. This is the stripper well bill, and as you know from our previous discussion there are 2 issues here. One is stripper well properties where a given unit of oil production is once labeled a stripper well then any additional wells produced are considered stripper wells right from the get go. The other issue is annual certifications of stripper wells as wells. What I asked Mr. Walstad to do was to remove that second issue from the table entirely. That would leave alone stripper wells as wells, no change, but would leave the removal of stripper well properties.

Senator Triplett – I will move 11.0783.01001.

Seconded by **Senator Dotzenrod**.

Senator Triplett explained the history of the stripper wells and stripper well property.

Chairman Cook – So you are taking out the recertification process. You want to remove the stripper well classification for wells that are part of the property.

Senator Hogue – I don't understand the history of the stripper well status and maybe Representative Onstad was trying to help with that but he gave us a couple of maps that had 2 sections on it and he thought that if there was a stripper well anywhere within those 2 sections, that would qualify a larger producing well with stripper well status because it's on a stripper property. Is that the current state of the law?

Chairman Cook – I believe so. They invest considerable money to take a low producing well to bring it up so that it might still continue to produce a small amount of oil. It gets stripper well status. It seems to me from what I understand is the incentive to make those investments and take those risks in the opportunity of having one on the property that might produce a little more oil at the stripper well status.

Senator Triplett – The argument that they Petroleum Council and the oil industry in general would make about stripper wells as wells is what you just said about the investment. They may own 5 or 7 or 12 or 15 wells around and about and invest in them and keep trying to work them and they might get one win occasionally. Their argument then is let's not penalize these little guys who are owning the work over rigs and going back in and trying and the average is like 4 barrels per well. I'm cool with letting them invest in them and maybe they make a ton of money off of one of them. What I'm not cool with is someone going in and drilling a Bakken well and just because it happens to be drilled in the near vicinity of an old vertical well that's mostly dry, that somehow a brand new Bakken well gets called a stripper well right from day one. And that's what's happening out there and that is not right. That is not what anyone in the Legislature intended. Lynn Helms said it's a loophole and no one noticed it for a long time and then a few oil companies started noticing it and using it and most of them would already qualify for enhanced recovery in other exemptions and could put those wells in other exemptions if they wanted to but they just do the stripper well one because it's convenient and it's forever.

Chairman Cook – So you are proposing a \$60 million tax increase on certain wells?

Senator Triplett – No, this will seriously affect the fiscal note I think.

Chairman Cook – How?

Senator Triplett – By leaving out all those stripper wells that are real stripper wells that have the well status. So I think we would have to ask for a new fiscal note.

Chairman Cook – I thought all we took off was annual certification?

Senator Triplett – Right, but the annual certification would have cut out a bunch of stripper wells and made them taxable.

Chairman Cook – Ok, we will get a new fiscal note.

Senator Dotzenrod – Might I suggest if we could get Lynn Helms sometime either today or tomorrow to talk to us a little bit about this I think it might clear it up some. We had the suggestion during the first hearing on this that a lot of these stripper well properties are turned over to new owners. Smaller companies come in and buy these and work on them and their production is fairly low. Some as low as 4 barrels a day. The objective of our amendments is to leave those people alone. To not affect them by what this does. One of the objections Mr. Helms had was how could he manage to do all these inspections. It's just too many. I don't see that we are going to affect the taxes that are being imposed because we've deleted section 1 and section 3. All you have left of this bill is section 2.

Chairman Cook – There was approximately 6.3 million barrels produced from 235 stripper wells or wells within stripper well properties that exceeded the average daily production limits. That's where the \$60 million fiscal note comes from.

Senator Triplett – If I could share some information that came from Kathy Strombeck in an email. This was based on December 2009 through November 2010 production records. There were 2,512 stripper wells of which 1,245 were property determined stripper wells and 1,271 were well determined stripper wells. So, about an even split. Property determined stripper wells, once labeled high producers, 220 of those wells were producing 6 million barrels of oil which is about 48.5% of total stripper barrels. So it's virtually a split of half and half of the dollars so there should be an affected fiscal note I would think.

Chairman Cook – You said 220, here she is saying 235 stripper wells that are exceeding the average daily production limits. We can certainly ask Kathy to look at the amendments and determine whether or not the fiscal note changes.

Senator Triplett rescinded her amendment until further information can be determined.

Chairman Cook closed discussion on SB 2363.

2011 SENATE STANDING COMMITTEE MINUTES

Senate Finance and Taxation Committee Lewis and Clark Room, State Capitol

SB 2363
2/8/2011
Job Number 14199

Conference Committee

A. Rittmiller

Explanation or reason for introduction of bill/resolution:

Relating to annual determination of stripper well status on an individual well basis under the oil extraction tax

Minutes:

Committee Work

Chairman Cook opened discussion on SB 2363.

Chairman Cook – The amendments offered yesterday removes the annual recertification of stripper wells, this is from Kathy Strombeck in regards to a question about the fiscal note. It also removes stripper properties so each well would stand on its own in determining stripper designations prospectively. Without the stripper recertification, the fiscal note would become 'cannot determine' in place of the \$60 million assigned to the original bill. The reason for this is all existing stripper wells and existing properties would remain and although there will be overall positive revenue associated with no new stripper properties, we cannot determine how many of them would have happened in the absence of this bill.

Senator Triplett – I did send an email to Lynn Helm asking if he could come down sometime this morning. I wasn't sure if I had done a very adequate job of explaining the distinction between stripper properties and stripper wells and I thought if there were any questions left that he could clarify that for people. So, if we could wait until he can appear before the committee before we take action I would appreciate that.

Chairman Cook – I would say we probably could. We've had it here a while, my look is the fiscal note. These amendments would remove the fiscal note but it's still going to have a fiscal impact.

Senator Hogue – Are you familiar with the Onstad and Meyer bill, does that deal with the stripper wells as well?

Chairman Cook – I do not know if it does, but that's probably the place where it should if it does not. I'm not sure where that bill is at.

Senator Triplett – This is a really specific issue. It really doesn't relate to public policy regarding the overall tax rates so I would disagree that it belongs with that bill. I think that bill needs to stand alone as a topic of what the appropriate tax rate on new production should be. This bill is more in the nature of correcting a technical problem with the taxing structure that has developed because of horizontal drilling and the vast distinction between the success rate and horizontal drilling vs. the old fashioned vertical wells. There simply is no longer any rational reason in our taxing structure to have a stripper property designation given the very high virtually nearly approaching 100% success rate with horizontal wells. This is really a technical correction that probably should have been made when horizontal drilling first got going, but it has nothing to do with tax policy in terms of what the correct rate is. It's more in the nature of a housekeeping bill quite frankly now that we've taken out the annual certifications for stripper wells as wells.

Chairman Cook – I always appreciate your opinion, but it's got quite a fiscal impact to fall underneath the category of housekeeping.

Senator Triplett – I will repeat my request for the record that we wait to take action on this until Mr. Helms has a opportunity to appear before the committee because I think there is some misunderstanding about the fiscal impacts still. I appreciate what Kathy Strombeck has said in clarifying it but many of these wells that are currently accepting a stripper property designation could properly get a 5 or 10 year exemption under enhanced oil recovery exemptions that we already have in place and they are simply taking advantage of this because, why shouldn't they, it's perpetual in nature. A 5 or 10 year exemption is still a very valuable exemption because as you all know oil wells have a decline curve and the very large majority of the production from any given well, even Bakken wells is in the first 2 to 3 years. So a 5 or 10 year exemption really gives them a huge tax benefit and the only way of actually considering the value of the increased revenue of this bill would be to subtract back out the exemptions that they could get if they properly applied for the 5 or 10 year exemption. Then the fiscal affect would be very minimal. It would be looking 5 or 10 years out, to see an honest fiscal note. Given that our policy here is to only ask our tax department to do 2 year fiscal notes, the impact would be virtually nothing because many of those properties would just reapply for enhanced oil recovery exemptions. This is really a non-issue almost except that it's a public relations issue. It gives the impression that we are giving something away for no reason when really we aren't. They could be applying for other exemptions so I don't think it has hardly any fiscal impact once you consider those issues. I would like you to hear that from someone who has more credibility with you than I do. That's the only reason I asked Lynn Helms to come down. I think it's very clear once you understand the situation.

Senator Oehlke – I wouldn't mind hearing from Lynn.

Chairman Cook – Senator Triplett, you had a question you wanted Lynn Helms to answer.

Senator Triplett – I have a brief series of questions if I may.

Chairman Cook – Lets keep it to questions and not have another hearing on this bill.

Senator Triplett – To start, can you briefly describe the distinction between stripper wells that are stripper wells on their own behalf vs. stripper wells that are stripper wells because they are part of a property?

Lynn Helms – I'm going to use an analogy to try to describe that for you. If you consider this red envelope to be the pool that the oil and gas are going to be produced from, and you drilled a well into that pool, that well could be qualified in 2 different ways. One way is as a stripper well stand alone which means it is for that well and that pool only. Any other well drilled in the spacing unit or anywhere around the well would be treated not as a stripper well. If this well was drilled and then certified as a stripper well property, then that pool across the entire spacing unit or enhanced recovery unit, is now a stripper well pool. So we could come in and add additional wells to it at any point in time anywhere and they would also receive the stripper well tax incentive. Whether they were injection wells, producing well, whatever.

Senator Triplett – Can you tell us if you know what the reason for the incentive, the stripper well property incentive was when it was put in to place.

Lynn Helms – The original reason for stripper well property was that it was part of the windfall profits tax of the early 1980's. The windfall profits tax provided for stripper well exemptions to that, and so when the oil extraction tax was created in response of that windfall profits tax, that same definition came over. The concept again being that if you drilled a well and it was a very poor well, and qualified as a stripper well, it basically condemned that entire pool in that spacing unit as being marginal productivity and so provide some incentive to operators to come in and try additional new technologies perhaps. To get increased production even though that pool in that spacing unit had pretty much been condemned or in most people's minds, condemned by that first well.

Senator Triplett – Now that technology has changed rather dramatically in the oil fields, if there is an old property that is labeled as a stripper well property, and was like an old vertical well, if someone comes back in now and drills a horizontal well into the Bakken, would that now be eligible for stripper well status?

Lynn Helms – It sure would.

Senator Triplett – If the stripper well property, out of the law, which is what this bill as amended proposes to do, what other options are available to people, companies who are drilling new horizontal wells in the Bakken in terms of current exemptions that they could apply for if they weren't applying for stripper well property status?

Lynn Helms – In the Bakken, none, currently. They would have to unitize it and do an enhanced oil recovery or something like that to get the same type of tax treatment.

Senator Triplett – So can you talk about that in terms of where the stripper well property is being used but other tax exemptions are available in terms of enhanced oil recovery?

Lynn Helms - There are a couple recent ones. One of them is the Cedar Hills Unit in Bowman County where that has been done. The more recent one is the Glenburn Madison

Unit which was unitized about 3 years ago and has been certified as a stripper well property and is now undergoing water flood operations.

Senator Triplett – If those wells that are part of those 2 properties we've just identified, this bill is actually only prospective in its presentation, but if the property distinction had not been available to them 5 or 7 years ago, would those properties have been eligible for other kinds of exemptions when they got into the enhanced oil recovery?

Lynn Helms – Yes they would.

Senator Triplett – What kinds of exemptions would they have been eligible for?

Lynn Helms – I'll start with Cedar Hills North, the incremental oil from that pool which would be all oil basically produced from new wells in that pool would have been eligible for the tertiary enhanced oil recovery tax exemption which is a complete exemption from the 6.5% extraction tax for 10 years. The Glenburn Madison Unit incremental oil would be eligible for the water flood enhanced recovery tax exemption which is a complete exemption from the extraction tax for 5 years.

Chairman Cook – These other exemptions that they'd qualify for, they would have to make an initial investment, sizable investment before they would be eligible.

Lynn Helms – That is absolutely correct. They would have to go through the unitizing process and invest in an enhanced oil recovery project converting wells to injection and pumping something into the reservoir to increase recovery.

Senator Triplett – There is one more isn't there in terms of a carbon dioxide enhancement. Can you speak to that one?

Lynn Helms – That one is not being used right now but if the tertiary project utilizes carbon dioxide, then that exemption has no sunset on it. It is for the life of the entire time the pool produces.

Senator Triplett – To follow up on Chairman Cook's question, these 2 formations that you have just described, the investments have been made is that correct, in the enhanced oil recovery?

Lynn Helms – Yes, those investments have been made.

Senator Triplett – So the producers in that case had a choice when they made those investments they could have applied for the 5 or 10 year exemptions or they could apply for the stripper well exemption but they would have gotten 1 of those 3 exemptions depending on the circumstances.

Lynn Helms – Yes, and in fact in Cedar Hills they did apply for both. First they did the tertiary tax exemption and then they recognized there were advantages to the stripper well property so they came in and made application for that so they actually have both in place.

Senator Dotzenrod – I just want to make sure I understand what this bill does. If this bill were passed then the term stripper well property would disappear from the century code. We wouldn't have a stripper well property section anywhere else. This is the only place it appears so if we pass this then that designation disappears. Is that correct?

Lynn Helms – That's my understanding, yes.

Senator Dotzenrod – So if it got passed, it wouldn't affect those that have qualified up until now, it would only affect those places in the future.

Lynn Helms – We would probably need a little clarification from the amendment sponsors on that. It might affect historic stripper well properties in that, would a new well drilled in 2012 into an existing stripper well property which is grandfathered in, would that new well get the tax treatment that property brought or would it not. The effective date language in here leaves that undetermined in the bureaucrats eyes.

Vice Chairman Miller – Remind me where the Bakken is located in depth.

Lynn Helms – The Bakken would be roughly half way between the 2 pools that we have been talking about. The Madison pools are located up here at around 8,000 to 9,000 feet. The Bakken is from 10,000 roughly to 11,000 feet, and then the Red River is deeper down in the 12,000 to 13,000 feet level. The Bakken lies between the two.

Vice Chairman Miller – Most stripper wells are at what depth?

Lynn Helms – The vast majority of our stripper wells are Madison and they are at 8,000 feet and shallower.

Chairman Cook – We have before use SB 2363.

Senator Triplett – I would move the amendments labeled 11.0783.01001.

Seconded by **Senator Dotzenrod**.

Senator Triplett – I think it's relatively clear from the conversation but they basically remove all of section 1 all of section 3 which then the affect of that is that this bill no longer refers to annual recertification's of stripper wells as wells and it's only remaining section is section 2 which removes the designation as stripper well properties and then in addition we took Mr. Helms earlier advice and changed the phrase "during days of normal recovery operations" on line 19 and replaced it with "at the wells maximum efficient rate" which is a phrase that is already used in regulation.

Senator Burckhard – So is this still a tax increase?

Chairman Cook – It cannot be determined.

Chairman Cook – Ask the clerk to take the roll on the amendment for SB 2363. (2-5-0)
Failed.

Chairman Cook – Senator Triplett this session is far from over, if you would like to pursue this issue get a clean set of amendments. I voted no because we had a hearing on SB 2363, the bill was introduced at the very end; we did not have it in this committee that long. I've been getting calls today regarding these amendments and the confusion these amendments cause. I think this is a very serious tax issue and I think looking at these amendments we could have almost had a hearing on the amendments.

Senator Triplett – I think it's pretty clear that the amendments were intended very specifically to respond to the criticism that this bill in its original form was picking on the little guys in the oil industry and attempting to make life more difficult for them to certify stripper wells as wells and by removing all of that language relating to them what we have done is let the little guys in the oil industry, we have left them alone so that their stripper wells as wells are still in place and by leaving only the stripper well property in there we are simply proposing to remove what has become in my mind a completely egregious oversight in the law but yet the law already has all kinds of other exemptions as Mr. Helms testified to that these people could be getting exemptions on. So it's really almost a public relations kind of thing of saying we are not going to let people have the visual advantage of having a stripper well when what they really have is an enhanced recovery well for which they should be entitled to an exemption. This was a very clean and simple fix up and everybody in the industry who reads these amendments knows exactly what's going on.

Chairman Cook – The easiest way to find that out is to have a bill that is introduced to do just that. We have before us SB 2363. Committee your wishes?

Senator Triplett – I move a Do Pass.

Seconded by **Senator Dotzenrod**.

Chairman Cook – Any discussion? Ask the clerk to take the roll. (2-5-0) Failed

Vice Chairman Miller – I move a Do Not Pass.

Seconded by **Senator Hogue**.

Chairman Cook – Discussion? Ask the clerk to take the roll. (5-2-0)

Carried by **Senator Hogue**.

FISCAL NOTE

Requested by Legislative Council
01/26/2011

Bill/Resolution No.: SB 2363

1A. State fiscal effect: *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	2009-2011 Biennium		2011-2013 Biennium		2013-2015 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues				\$60,600,000		
Expenditures						
Appropriations						

1B. County, city, and school district fiscal effect: *Identify the fiscal effect on the appropriate political subdivision.*

2009-2011 Biennium			2011-2013 Biennium			2013-2015 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts

2A. Bill and fiscal impact summary: *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

SB 2363 requires an annual determination of stripper well status on an individual well basis.

B. Fiscal impact sections: *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

SB 2363, if enacted, would require all stripper wells and wells within stripper properties to individually qualify for stripper status each year. Based on the most recent 12-month period, there was approximately 6.3 million barrels produced from 235 stripper wells or wells within stripper properties that exceeded the average daily production limits in statute for the stripper well exemption. Under the provisions of SB 2363, this production would have become subject to the state's oil extraction tax.

Assuming no change in this production volume, the provisions of SB 2363 if enacted, could be expected to increase revenues to the legacy fund, the permanent oil tax trust fund, education funds, and the resources trust fund by an estimated \$60.6 million in the 2011-13 biennium.

3. State fiscal effect detail: *For information shown under state fiscal effect in 1A, please:*

A. Revenues: *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

B. Expenditures: *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

C. Appropriations: *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation is also included in the executive budget or relates to a continuing appropriation.*

Name:	Kathryn L. Strombeck	Agency:	Office of Tax Commissioner
Phone Number:	328-3402	Date Prepared:	01/28/2011

Date: 2-8-11
Roll Call Vote # 1

2011 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 2363

Senate Finance and Taxation Committee

Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken: Do Pass Do Not Pass Amended Adopt Amendment

Rerefer to Appropriations Reconsider

Motion Made By Senator Miller Seconded By Senator Hogue

Senators	Yes	No	Senators	Yes	No
Dwight Cook - Chairman	X		Jim Dotzenrod		X
Joe Miller - Vice Chairman	X		Connie Triplett		X
Randy Burckhard	X				
David Hogue	X				
Dave Oehlke	X				

Total (Yes) 5 No 2

Absent 0

Floor Assignment Senator Hogue

If the vote is on an amendment, briefly indicate intent:

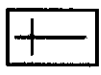
REPORT OF STANDING COMMITTEE

SB 2363: Finance and Taxation Committee (Sen. Cook, Chairman) recommends DO NOT PASS (5 YEAS, 2 NAYS, 0 ABSENT AND NOT VOTING). SB 2363 was placed on the Eleventh order on the calendar.

2011 TESTIMONY

SB 2363

Bethany Cem



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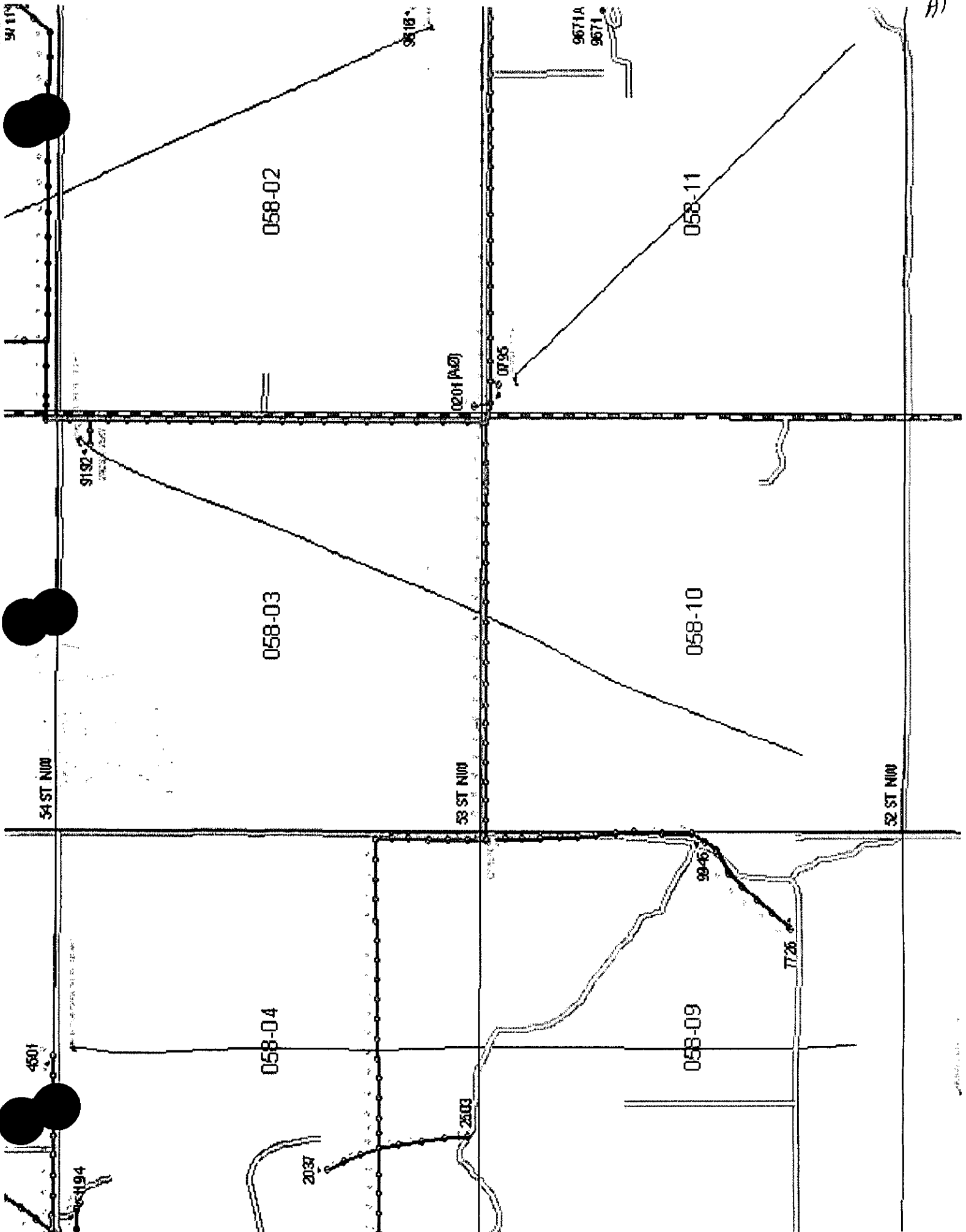
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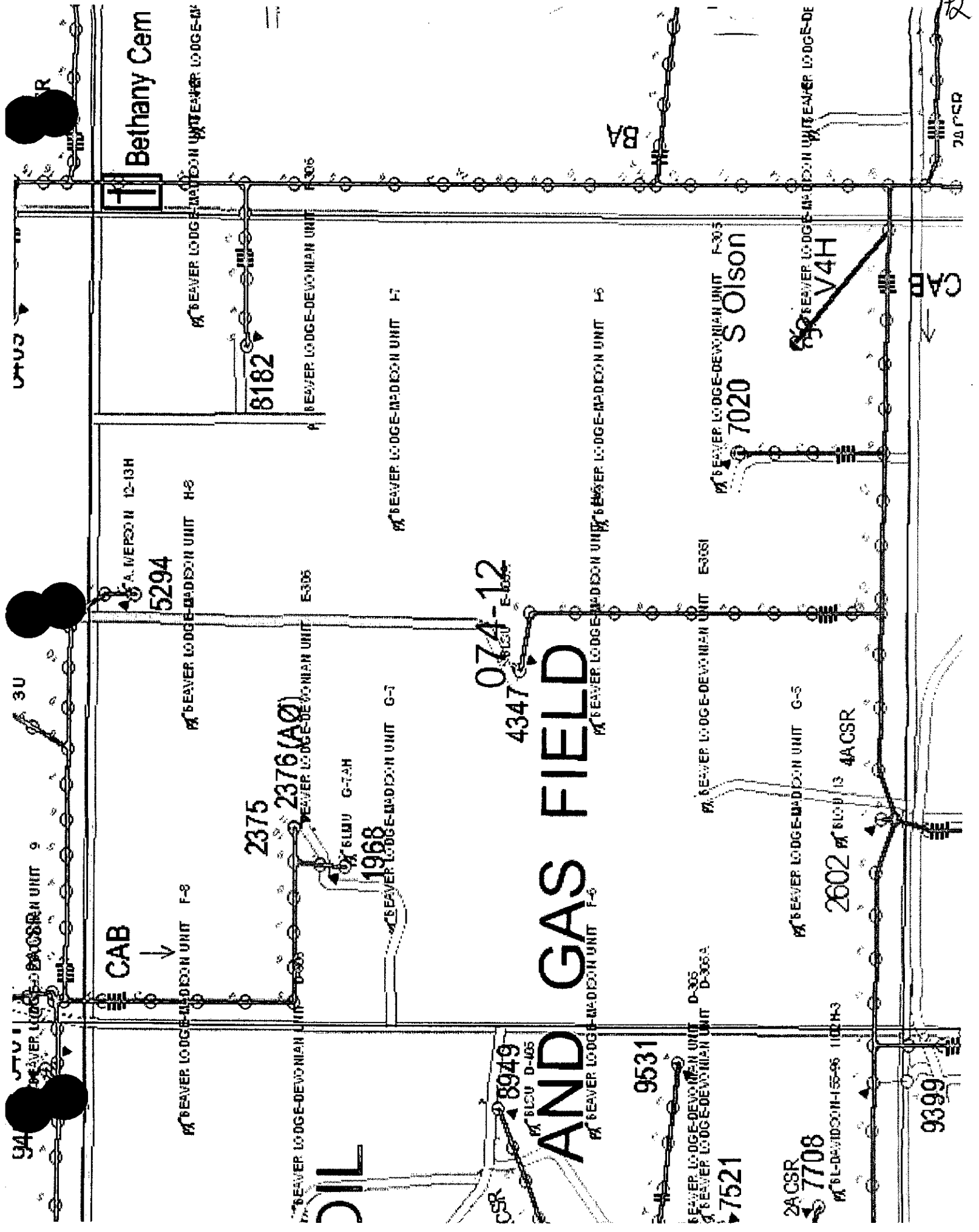
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Bethany Cem

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BEAVER LODGE-DEVONIAN UNIT F-8

BEAVER LODGE-MADISON UNIT H-8

BEAVER LODGE-DEVONIAN UNIT D-305

BEAVER LODGE-DEVONIAN UNIT E-306

BEAVER LODGE-MADISON UNIT G-3

BEAVER LODGE-MADISON UNIT F-7

BEAVER LODGE-MADISON UNIT F-6

BEAVER LODGE-MADISON UNIT F-5

BEAVER LODGE-DEVONIAN UNIT D-305

BEAVER LODGE-DEVONIAN UNIT E-306

2A CSR

BEAVER LODGE-DEVONIAN UNIT H-102 H3

BEAVER LODGE-MADISON UNIT G-5

BEAVER LODGE-DEVONIAN UNIT F-305

BEAVER LODGE-MADISON UNIT H-102 H4

7A CSR

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BEAVER LODGE-DEVONIAN UNIT 9

BA

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7A CSR



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Senate Bill 2363
Senate Natural Resources Committee
January 31, 2011

Chairman Cook and members of the Committee, my name is Ron Ness. I am President of the North Dakota Petroleum Council. The North Dakota Petroleum Council represents 260 companies involved in all aspects of the oil and gas industry including oil and gas production, refining, pipeline, transportation, mineral leasing, consulting, legal work, and oil field service activities in North Dakota, South Dakota, and the Rocky Mountain Region. I appear before you today in opposition to Senate Bill 2363.

The budget projection for 2011 – 2013 biennium indicates that the oil and gas industry will pay more than two billion in oil and gas production taxes. **SB 2363 is a big tax increase on a small segment of the oil industry. Stripper wells or marginal wells account for 39% of the oil wells in North Dakota and 8% of the production.** Why are we targeting this small segment of industry? SB 2363 places an additional tax burden on a segment of the state's oil industry that is important to the stability of industry and helps provide jobs during the peaks and valleys that the oil industry experiences. Stripper properties, or marginal wells, are a foundation for the domestic oil industry. Marginal oil wells represent 18% of our nation's domestic oil production. These wells are generally owned by small independent operators who have purchased them from large operators after oil production declines. Generally, small North Dakota oil operators take ownership and assume the risk of trying to increase production of these wells. This risk has to have a financial incentive in order to keep these wells active and continue to invest in new technology or production techniques that increase their production. Oil

industry investment is always driven by price and economics. North Dakota competes with the rest of the nation and the world to attract investment. In the last several years, the state's oil patch has become a hotbed in the United States for interest and investment and our economy is certainly seeing the benefits but most of that interest has been focused on the Bakken Play. The wells we are referring to in this bill are typically older oil producing formations. Using new technology or engineering techniques to these wells when successful keeps the wells producing and the jobs associated with it. It also increases the value to the producer, mineral and royalty owner, and the state of North Dakota.

This bill does not encourage investment.

Reasons why stripper wells are taxed at fixed rates:

- Producers need certainty to justify maintaining production from stripper wells.
- Capital expenditures on low rate wells are very risky. Decline rates for wells are very steep, so increase in rate is not long-lasting. To encourage operators to enhance production (via stimulation, work over, or re-entry), maintaining the 5% - 6.25% tax on strippers is beneficial to the state.
- There is a sound business case for the stripper wells. Production from these wells contributes greatly to North Dakota's tax surplus. Maintaining activity level is essential.
- It takes nearly as many employees to run a small well as a large well.
- There is a large paperwork burden involved for industry and the state with passage of this bill.
- Discouraging investment in aging oil wells makes no sense, this is a small business that you are encouraging to close rather than assume risk and grow.

Other states marginal well numbers dwarf North Dakota's.

<u>State</u>	<u># of Marginal Wells</u>	<u>Annual Production</u>	<u>Average Daily Production</u>
North Dakota	1,471	2,370,729 barrels (bbls)	4.42 barrels of oil per day (bopd)
Montana	2,532	2,017,196 bbls	2.18 (bopd)
Wyoming	12,572	8,263,340 bbls	1.67 (bopd)
Oklahoma	45,892	27,911,928 bbls	2.39 (bopd)

2008 Marginal Oil Well Survey (Source: Interstate Oil and Gas Compact Commission)

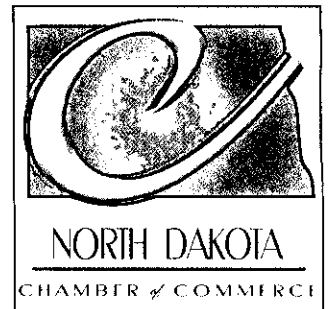
Comments from a North Dakota producer:

Stripper wells – re-qualifying yearly:

“Wells do not **incline**, unless they are advantageously affected by a water flood, or improved by work over/re-entry drilling. All of these events involve the oil company risking money to try to improve production. If the production increase does happen, the state gets their 5% tax revenue on a higher volume. If the production increase doesn't happen, the oil company shoulders the burden for its investment efforts. The state should support that investment effort, because that equates to both jobs and tax revenues.”

This bill is a step in the wrong direction. The oil and gas industry is paying more than its fair-share in taxes to North Dakota. This bill represents a tax increase. We urge a Do Not Pass on SB 2363.

I would be happy to answer any questions.



Testimony of Bill Shalhoob
North Dakota Chamber of Commerce
SB 2363
January 31, 2011

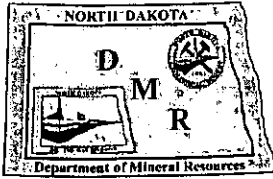
Mr. Chairman and members of the committee, My name is Bill Shalhoob and I am here today representing the North Dakota Chamber of Commerce, the principal business advocacy group in North Dakota. Our organization is an economic and geographical cross section of North Dakota's private sector and also includes state associations, local chambers of commerce, development organizations, convention and visitors' bureaus and public sector organizations. For purposes of this hearing we are also representing five local chambers with over 5,000 members. As a group we stand in opposition to SB 2363 and urge a do not pass from the committee on this bill.

We oppose this bill for several reasons. First, it is a tax increase on an industry that is already accounting for over 30% of the general fund revenue for North Dakota. Second, it is a tax increase at a time when state coffers are substantial and we should be cutting taxes, not raising them to create more excess revenue. Most importantly, this particular tax increase is counter-productive to sound tax policy as the oil industry in North Dakota develops and matures. The Chamber was supportive of the stripper well exemption when it was enacted and we continue to support it today. At the time it was given oil taxes were around \$100 million per biennium and we were trying to encourage operators to continue to operate marginal wells instead of capping them and walking away. Regardless of the ability to drill a new, productive well, business will always look at eliminating non-profitable wells. It took us a long time and development of sound tax policies to reach the production point we are at today with the advancements in both drilling and recovery sciences. Why would we put those advancements and our growth at risk with tax policy that does not take the long term approach? Next time we not be able to restart the marginal recovery efforts that collectively provide a substantial return for our state.

Thank you for the opportunity to appear before you today in opposition to SB 2363. I would be happy to answer any questions.

THE VOICE OF NORTH DAKOTA BUSINESS

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SENATE BILL NO. 2363

Senate Finance and Taxation
January 31, 2011

Testimony of Lynn D. Helms, Director

The Industrial Commission's Department of Mineral Resources (DMR) Oil and Gas Division has jurisdiction over determination and certification of stripper wells and stripper well properties under NDCC 38-08-04.

Summary – Senate Bill 2363 does two things. First it requires all stripper wells to be certified on an annual basis and second the bill eliminates the category known as stripper well properties.

There are currently 2,345 qualified stripper wells (39% of total producing wells) in North Dakota which produce approximately 28,000 barrels of oil per day (8% of total production) for an average of 12 barrels of oil per day per well. Recent employment studies indicate that each of those wells supports one full time job so just under 2,350 full time jobs in our state depend on stripper wells.

Annual Certification – current law grants a permanent exemption for that well and pool from the North Dakota Oil Extraction Tax for wells that are certified as stripper wells. The Oil and Gas Division reviews each application to determine if the well qualifies and was produced at maximum efficient rate during the 12 month qualifying period. This is an engineering analysis of days produced, oil production, gas production, and water production over an extended period of time to confirm that the operator did not manipulate production by shutting the well in periodically, slowing the pump down, or using some other method of meeting the production rate limit.

In 2010 we reviewed 96 applications and certified 95. Our website has an application that allows operators to evaluate their well using the same tools we use to eliminate filing of unqualified applications. There is a tremendous difference between reviewing 96 new applications (less than two per week) and reviewing 2,345 wells plus 96 new applications (9 per day). This is currently a minor portion of the job duties of one Petroleum Engineer, but as written SB 2363 makes it a full time job that would require one additional FTE. You have probably heard that we don't have a lot of spare time at the Oil and Gas Division these days. A substantial amount of that engineers time is now spent writing commission orders yet we still have a back log of 418 cases that have been heard, but no order signed.

Finally, annual recertification severely reduces the incentive for an operator to perform work on a well to increase production. This could be anything from a pump change to a horizontal re-entry that would extend the life of the well and the job it supports.

Stripper well property – current law allows the operator to qualify an entire lease or even an enhanced oil recovery unit and the pool it produces from as a stripper well property if the average per well production is below the qualifying limit. With this certification all production from that property receives a permanent exemption from the North Dakota Oil Extraction Tax. This even includes drilling new wells in the property that produce far in excess of the qualifying rate like the current 292 barrel per day stripper well and 37 stripper wells that produce over 100 barrels of oil per day, but it is also a huge incentive for investment and maximumizing oil recovery from a stripper well property.

Page 1 Line 19 – creates the undefined term "during days of normal recovery operations". This terminology is confusing and should be amended to the commission term "Maximum efficient rate".



SENATE BILL NO. 2363

Senate Finance and Taxation
February 2, 2011

Chairman Cook and members of the Senate Finance and Taxation Committee,

I am writing to provide information requested at the hearing on the above subject bill.

You asked how many Bakken wells are certified as stripper wells:

- 1) There are 257 Bakken stripper wells:
 - a. 195 are stripper wells and 62 are stripper well properties
 - b. 196 are upper shale horizontal wells and vertical wells from before the 2006 Parshall discovery and 61 are modern middle Bakken–Three Forks wells

You asked how many current stripper wells would receive an enhanced oil recovery tax incentive:

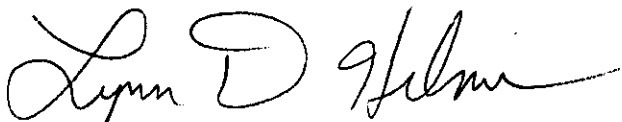
- 1) The topic is very complex and my testimony was brief and not quite complete:
 - a. Only the incremental oil, or oil that is above the pre enhanced oil recovery rate, from enhanced oil recovery projects is exempt from the extraction tax.
 - i. The new wells that are receiving the stripper well property exemption would be producing incremental oil so they would also receive the tertiary tax exemption.
 - b. Only carbon dioxide enhanced oil recovery projects have no time limit on the exemption. For all other tertiary projects the incremental oil exemption ends after ten years.

- i. The Cedar Hills North Red River B Unit was certified for tertiary recovery on 2/27/2004. Incremental oil from this unit will be exempt through 2/26/2014 by which time the wells receiving the stripper well property tax exemption are expected to decline to rates low enough to qualify as individual stripper wells.
- c. There are 519 wells certified as stripper wells due to an enhanced oil recovery unit stripper well property certification:
 - i. 78 are in Cedar Hills North Red River B Unit as discussed above
 - ii. 33 are in various water flood units and would qualify for the same tax exemption, but as incremental oil produced in the first five years of water flood enhanced oil recovery.
 - iii. 485 would qualify as stripper wells based on rate and depth
 - iv. 34 wells with total production of approximately 2,475 barrels of oil per day would not receive an extraction tax exemption if they were not stripper well unit property wells.

You asked about new wells in stripper well properties.

- 1) The stripper well property designation is pool specific so that a new well drilled within the property but to a different formation than the certified pool will not get the stripper well tax exemption.
- 2) Only if the new well produces from the same formation (pool) as the stripper well property will it get the stripper well tax exemption.

Sincerely,



Lynn D. Helms
Director