SB 19-181

Legislative Council Staff

Nonpartisan Services for Colorado's Legislature

FINAL FISCAL NOTE

Drafting Number:	LLS 19-0973	**Date:**	September 6, 2019
Prime Sponsors:	Sen. Fenberg Rep. Becker	**Bill Status:**	Signed into Law
		Fiscal Analyst:	Josh Abram | 303-866-3561 josh.abram@state.co.us

Bill Topic: PROTECT PUBLIC WELFARE OIL & GAS OPERATIONS

Summary of Fiscal Impact:

☒ State Revenue
☒ State Expenditure
☐ State Transfer
☐ TABOR Refund
☒ Local Government
☐ Statutory Public Entity

The bill expands the regulatory charge of the Department of Natural Resources related to oil and gas production, and allows local governments to also regulate oil and gas operations within their jurisdictions. The bill increases state government revenue and expenditures and may also impact local government revenue and expenditures on an ongoing basis.

Appropriation Summary: For FY 2019-20, the enacted bill includes an appropriation of $851,010 to the Department of Natural Resources.

Fiscal Note Status: This fiscal note reflects the enacted bill.

Table 1
State Fiscal Impacts Under SB 19-181

		FY 2019-20	FY 2020-21
Revenue	Cash Funds	$3.0 million	$3.0 million
	Total	**$3.0 million**	**$3.0 million**
Expenditures	Cash Fund	$851,010	$2,281,348
	Centrally Appropriated	$110,005	$308,083
	Total	**$961,015**	**$2,589,431**
	Total FTE	**7.0 FTE**	**16.0 FTE**
Transfers		-	-
TABOR Refund		-	-

Summary of Legislation

This bill modifies the composition and the regulatory charge of the Colorado Oil and Gas Conservation Commission (COGCC) in the Department of Natural Resources (DNR), expands the regulatory charge of the Colorado Department of Public Health and Environment (CDPHE), imposes new requirements on oil and gas operators, and provides additional regulatory authority over oil and gas operations to local governments.

Colorado Oil and Gas Conservation Commission. Under current law, the Oil and Gas Conservation Act declares that it is in the public interest to *foster* the responsible, balanced development, production, and utilization of natural resources of oil and gas in a manner that is consistent with public health, safety, and welfare, including protection of wildlife resources. Current law also requires that the COGCC take into consideration cost-effectiveness and technical feasibility when making decisions or taking actions to minimize the adverse impacts of oil and gas development. This bill modifies the legislative declaration to direct the COGCC to *regulate* the development of oil and gas in a manner that protects public health, safety, and welfare, including protection of wildlife resources, and removes the cost-effectiveness and technical feasibility test. The bill also requires that the DNR hire up to two deputy directors.

Either on July 1, 2020, or on the date that all required rules are adopted, whichever is earliest, the bill:

- reduces the size of the COGCC from nine to seven members (five appointed members and two ex-officio members);
- adjusts the required areas of commissioner expertise;
- changes appointing authorities; and
- requires that the five appointed commissioners be employed as full time salaried employees of the commission (under current law, COGCC commissioners serve without compensation).

COGCC rules. The bill requires that the COGCC review and, if necessary, amend existing rules related to flowlines and inactive, temporarily abandoned, and shut-in wells. The commission must adopt new rules for drilling application fees, estimating financial assurances provided by operators, conducting alternative location analysis, ensuring proper wellhead integrity for production wells, the certification of various compliance officers, and the operation of technical review committees. The director of the COGCC may deny permit applications in lieu of additional environmental analysis while the commission adopts newly required rules.

The COGCC must review leak detection and repair rules for oil and natural gas well production facilities and compressor stations, and specifically consider adopting more stringent provisions, including a requirement that all production facilities conduct semi-annual leak detection and repair inspections, that owners and operators of oil and gas transmission pipelines and compressor stations inspect and maintain equipment and pipelines on a regular basis, and that operators install and operate continuous methane emissions monitors at facilities with large emissions potential, at multi-well facilities, and at facilities in close proximity to occupied dwellings.

The COGCC must adopt rules to ensure proper wellbore integrity of production wells, which must consider incorporating recommendations from the State Oil and Gas Regulatory Exchange. Welbore integrity rules must address the permitting, construction, operation, and closure of production wells, require that wells be constructed using current standards that protect water zones and prevent blowouts, enhance safety and environmental protections during operations, require regular integrity assessments, and address the use of nondestructive testing of weld joints.

COGCC fees. The bill removes existing monetary caps on permitting fees, and allows the COGCC to charge a permit application fee in an amount sufficient to cover all direct and indirect costs.

Reporting. The director of the COGCC must submit a report to the General Assembly by January 1, 2021, regarding any recommended structural changes to the commission, a summary of relevant information learned from other states' gas commissions, and an analysis of the commission's scientific expertise in the areas of oil and gas mineral resource development.

Environmental response fund. Current law requires that the COGCC ensure that the 2-year average of the unobligated portion of the Oil and Gas Conservation and Environmental Response Fund does not exceed $6.0 million, and retains an adequate balance in the environmental response account to address environmental response needs. The bill requires that the unobligated portion not exceed 50 percent of total appropriations from the fund for the upcoming fiscal year and that there is an adequate balance in the response account to support the operations of the commission and to address environmental response needs.

Statutory pooling of mineral interests. The bill permits the COGCC to authorize more than one drilling unit in a statutory pooling order only if more than 50 percent of the mineral interests consent to be pooled. The bill prohibits an operator form using the surface property of a non-consenting owner without the owner's permission.

Current law sets the royalty that a non-consenting owner is entitled to receive at 12.5 percent of the full royalty rate until the consenting owners have been fully reimbursed for their costs. The bill raises a non-consenting owner's royalty rate during this pay-back period from 12.5 to 13.0 percent and makes a corresponding reduction to the portion of the non-consenting owner's royalty from which the consenting owners' costs are paid.

Colorado Department of Public Health and Environment. The bill requires that the Air Quality Control Commission (AQCC) in the CDPHE adopt rules to minimize emissions of methane and other hydrocarbons and nitrogen oxides, and to regulate air pollution from oil and gas facilities during all segments of the oil and natural gas supply chain. The AQCC must also review leak detection and repair rules for oil and natural gas production facilities and compressor stations, and consider adopting more stringent provisions.

Oil and natural gas operators. The bill requires that an operator of an oil and gas facility install continuous monitoring equipment for hazardous air pollution. Depending on rules adopted by regulatory agencies, operators may also be required to conduct semi-annual leak detection and repair inspections and inspect and maintain transmission pipelines and compressor stations on a regular basis. The bill creates additional permitting requirements for operators, including a requirement that operators file applications with affected local governments before applying to the COGCC.

Local governments. The bill removes the state preemption of oil and gas regulation and expands the authority of local governments to regulate oil and gas development within their jurisdictions, including the local government's ability to zone land use for mineral resource development; to site, monitor, and inspect oil and gas facilities; and to impose fees and fines.

The bill permits a local government or an oil and gas operator to request that the COGCC convene a technical review board to evaluate the effect of a local government's preliminary or final determination on an operator's application.

If there is a conflict between the regulations or standards of a local government and any state agency, or between state agencies regarding the exercise of authority over oil and gas development, this bill requires that the regulation that is rationally designed to be more protective of public health and the environment takes primacy over the conflicting regulation.

Background

State and local taxes from oil and gas development. Companies that extract mineral resources, including oil and natural gas, pay severance taxes to the state and property taxes to local governments. In FY 2016-17, the industry paid a total of $473.6 million in taxes, including $469.6 million in property taxes and $4.0 million in severance taxes. In FY 2017-18, total taxes were $813.7 million, including $687.1 million in property taxes and $126.6 million in severance taxes. Severance tax revenue is split between state programs and local governments. These estimates do not include revenue from corporate income taxes, individual income taxes, sales taxes, use taxes or the contribution in state trust land revenue or federal mineral leasing payments attributable to oil and gas development.

State revenue in FY 2017-18 is calculated based on production values in 2016 and 2017, when production was increasing. A significant portion of severance and property taxes come from new oil and gas wells, since production from these wells is highest during the first 2-3 years.

Total production of oil and gas and related tax collections are a product of multiple macroeconomic factors, including the global price of oil and natural gas, technological advances, and production trends. Oil and gas regulations are only one consideration for the industry when deciding to develop resources; other factors include the cost of extraction, the existence of supporting infrastructure, the ability to market extracted resources, tax rates, existing business commitments, and prevailing prices. Table 2 shows 2018 oil and gas production for the 10 highest producing counties of each resource.

Table 2
2018 Oil and Gas Production by County

Oil Production			Natural Gas Production		
County	**Barrels**		**County**	**Mcf (1,000 Cu Ft)**	
Weld County	149,189,227	89.0%	Weld County	778,383,212	43.0%
Rio Blanco County	3,759,105	2.2%	Garfield County	491,425,909	27.1%
Larimer County	3,734,852	2.2%	La Plata County	294,038,344	16.2%
Adams County	2,938,384	1.8%	Rio Blanco County	51,493,890	2.8%
Arapahoe County	2,105,223	1.3%	Mesa County	56,571,338	3.1%
Garfield County	1,450,385	0.9%	Las Animas County	50,951,440	2.8%
Jackson County	1,286,617	0.8%	Yuma County	17,374,297	1.0%
Cheyenne County	949,707	0.6%	Archuleta County	15,714,674	0.9%
Lincoln County	685,524	0.4%	Larimer County	10,712,314	0.6%
Washington County	430,934	0.3%	Moffat County	9,647,938	0.5%
Remainder of State	1,131,292	0.7%	Remainder of State	34,462,195	1.9%
Total	**167,661,250**	**100.0%**	**Total**	**1,810,775,551**	**100.0%**

Source: Colorado Oil and Gas Conservation Commission.

Local property taxes and school finance. The money to fund the School Finance Act comes from a combination of local and state sources, primarily local property taxes and state income taxes. In FY 2017-18, the cost of school finance was about $6.6 billion. Local property and specific ownership taxes contributed 38 percent of this funding, which includes local property taxes paid on the production of oil and natural gas, and state tax revenue contributed 62 percent. These percentages vary widely among individual school districts due to local differences in property wealth and tax rates. State aid, primarily from the General Fund and the State Education Fund provides the difference between a district's total school finance act funding and the local share. In school finance, this concept of state assistance backfilling local resources is called "equalization."

State Revenue

This bill increases state revenue from application fees to the COGCC by $3.0 million per year starting in FY 2019-20, and may impact severance tax revenue in the future.

Fee impact on oil and gas operators. Colorado law requires legislative service agency review of measures which create or increase any fee collected by a state agency. These fee amounts are estimates only, actual fees will be set administratively by DNR based on cash fund balance, program costs, and the number of permits subject to the fee.

Currently, the COGCC's estimated cost to process a request for a new oil and gas location is approximately $1,000, and the estimated cost to process an application for a permit to drill is approximately $300. Current law caps fee amounts at $200; however, under current practice the DNR does not charge any permit fees. This bill permits the DNR to establish fee amounts in rule. The DNR estimates that the COGCC processes about 600 new oil and gas location applications, and 8,000 permit to drill applications annually. Based on this volume of applications and an anticipated increase in fee amounts, the bill will increase state revenue. State revenue from fees is subject to the TABOR revenue limits in the state constitution; however, under the March 2019 LCS forecast, a TABOR surplus is not expected in either FY 2019-20 or FY 2020-21. Table 3 identifies the estimated fee impact of this bill.

Table 3
Fee Impact on Oil and Gas Operators

Fiscal Year	Type of Fee	Proposed Fee	Number Affected	Total Fee Impact
FY 2019-20	Oil & gas location assessment	$1,000	600	$600,000
	Application to drill	$300	8,000	$2,400,000
			FY 2019-20 Total	**$3,000,000**
FY 2020-21	Oil & gas location assessment	$1,000	600	$600,000
	Application to drill	$300	8,000	$2,400,000
			FY 2020-21 Total	**$3,000,000**

Severance tax revenue. Because severance taxes are calculated in arrears, currently producing wells determine the amount of severance taxes collected in FY 2019-20 and FY 2020-21. This bill will not affect production of currently operating wells during this time, and therefore has no anticipated impact on tax revenue in these fiscal years.

The measure's future impact on tax revenue will depend on the type of regulations that state agencies and local governments implement, and the effects those regulations have on business decisions to develop oil and gas resources. Since the future actions of state agencies, local governments and business operators are unknowable, a change in state tax revenue cannot be estimated.

State Expenditures

The bill increases state expenditures by $961,015 and 7.0 FTE in FY 2019-20, and by about $2.6 million and 16.0 FTE in FY 2020-21. State expenditures are in the Department of Natural Resources, including Colorado Parks and Wildlife (CPW), and the Department of Law. The bill also increases workload for the CDPHE. The bill potentially impacts state funding for school finance in the future. New expenses are displayed in Table 4 and described below.

Table 4
Expenditures Under SB 19-181

Cost Components	FY 2019-20	FY 2020-21
Department of Natural Resources		
Personal Services	$524,369	$1,848,158
Operating and Capital Outlay	$33,918	$56,577
Staff Travel	$15,288	$31,428
Staff Vehicle Lease	$6,038	$6,038
Staff Technical Training	$2,500	$1,350
Rule Making	$43,363	$43,363
Leased Space	$39,000	$107,900
Legal Services - Department of Law	$186,534	$186,534
Centrally Appropriated Costs*	$110,005	$308,083
FTE – Personal Services	6.0 FTE	15.0 FTE
FTE – Legal Services	1.0 FTE	1.0 FTE
TOTAL	**$961,015**	**$2,589,431**
Total FTE	**7.0 FTE**	**16.0 FTE**

** Centrally appropriated costs are not included in the bill's appropriation.*

Personal services - Department of Natural Resources. Beginning in FY 2019-20 and ongoing, the bill increases personal services costs for the DNR. The bill requires that DNR hire 2.0 FTE additional deputy directors. New rulemaking and modified regulatory requirements necessitate 1.0 FTE for administrative support, 1.0 FTE for a toxicologist to assist with rulemaking and ongoing environmental regulation, and 1.0 FTE for a financial assurance specialist to assist with estimating necessary surety. Beginning in FY 2020-21, the bill also requires that 5.0 COGCC commissioners be full-time salaried employees, which also increases the need for 2.0 additional program staff. Depending on the rules adopted by the COGCC, the DNR may require additional FTE beginning in FY 2020-21 and FY 2021-22 to implement new regulatory requirements. This cost has not been estimated.

The CPW will also require 1.0 FTE new staff to assist those counties and local governments that choose to regulate oil and gas operations more stringently than the COGCC. Assuming up to 20 local governments choose some form of regulation over oil and gas, CPW expenditures increase to consult and advise governing boards and staff, to assist with local implementation, and for travel.

Personal services - Department of Public Health and Environment. For FY 2019-20 only, the bill increases workload in the Colorado Department of Public Health and Environment to assist the Board of Health to adopt rules to minimize emissions of methane and other hydrocarbons and oxides of nitrogen, and to regulate air pollution from oil and gas operations. This workload is estimated at 1,040 hours, or the equivalent of 0.5 FTE; however, the CDPHE can accomplish this workload within existing appropriations. Depending on the rules adopted by the state board, the department may require additional FTE beginning in FY 2020-21 and FY 2021-22 to regulate air pollution. This cost has not been estimated.

Staff travel, vehicle lease, and technical training. New DNR staff will incur travel expenses as part of their routine duties, including mileage reimbursement, vehicle lease, hotel and meals. Regulatory staff at DNR will require additional training and professional development to understand and implement the modified charge of the COGCC.

Rule making- travel reimbursement and contracted services. The bill requires the COGCC to modify existing rules and also adopt new ones. The required rules will be highly technical, and due to necessary stakeholder engagement, will likely require a minimum of 24 days of rule making. This effort increases state costs for meeting space and catering, travel reimbursement for COGCC members and staff, and to contract for an engineering consultant and a certified industrial hygienist to assist the COGCC with the adopted rules specified in the bill. Rule making and associated costs are assumed to span the next two fiscal years.

Legal services. The Attorney General's office will assist the DNR with rule making and related legal services estimated at 1,800 hours annually, or the equivalent of 1.0 FTE.

School finance. When local sources of school finance are reduced, such as a potential reduction in property taxes from limited oil and gas production, pressure is created for the state to equalize that reduction in local share; however, since FY 2010-11, the General Assembly has used the budget stabilization factor to proportionally reduce the amount of state equalization to address state budgetary demands. The budget stabilization factor imposes a uniform percentage reduction on total and per pupil funding for all districts not fully funded with local sources.

Centrally appropriated costs. Pursuant to a Joint Budget Committee policy, certain costs associated with this bill are addressed through the annual budget process and centrally appropriated in the Long Bill or supplemental appropriations bills, rather than in this bill. These costs, which include employee insurance, and supplemental employee retirement payments are estimated to be $110,005 in FY 2019-20 and $308,083 in FY 2020-21.

Local Government

The bill's impact on local revenue and expenditures will depend on the type of regulations, if any, a local government chooses to adopt. Local regulatory programs will increase a local government's expenditures and could also impact the amount of property taxes collected by counties, school districts, and special districts. Regulations that contribute to decisions to reduce new drilling will reduce future local property tax collections, since producing well sites have higher assessed value than non-producing areas. Since the type and location of potential regulations adopted at the local level are unknowable, the change in local revenue and expenditures cannot be estimated. The bill potentially impacts the amount of severance tax revenue that state government collects and then shares with those local governments most directly impacted by oil and gas development.

Effective Date

The bill was signed into law by the Governor and took effect May 16, 2019. The enacted bill applies to conduct occurring on or after that date, including determinations of applications pending on that date.

State Appropriations

Consistent with this final fiscal note, for FY 2019-20, the bill includes total cash funds appropriations of $851,010 in the following amounts:

- $763,180 from the Oil and Gas Conservation and Environmental Response Fund to the Department of Natural Resources and 5.0 FTE;
- $186,534 of the above amount in reappropriated funds to the Department of Law and 1.0 FTE; and
- $87,830 from the Wildlife Cash Fund to Colorado Parks and Wildlife and 1.0 FTE.

State and Local Government Contacts

Counties	Information Technology	Judicial
Law	Local Affairs	Municipalities
Natural Resources	Public Health	Revenue