October 24, 2012

Texas House of Representatives

Public Hearing

HOUSE COUNTY AFFAIRS COMMITTEE

Invited Testimony

Interim Charge #1: Study county-related issues arising from population growth in unincorporated areas with regard to existing and new developments and the provision of services, including garbage disposal, fire protection, road maintenance, electricity, and water and wastewater service. Make necessary legislative recommendations for improving problems in these areas of the state.

Witness: Daryl L. Fowler, DeWitt County Judge

Impacts of Eagle Ford Shale Oil and Gas Development on the County Road Infrastructure

and

Suggested Solutions for the Funding of Road Maintenance, Repairs, and Construction

Opening Remarks

- The Oil and Gas industry is of tremendous economic value to the State
- The industry depends upon good roads to accommodate traffic and safety needs
- Public safety is of primary importance
- More than 60,000 jobs to be created by the Eagle Ford Shale
- More than $700 million annual Severance Tax from Eagle Ford Shale production
- 20 to 40 year anticipated life of the Play
- State highway systems experiencing rapid decline – 20 year life consumed in less than 5 years
- County roads destroyed by the movement of one 6 million pound rig movement
- 14 counties directly impacted by drilling, many more impacted by traffic and commercial activity

Presentation:

I. Constitutional and Statutory Obligation to Maintain County Roads Held in Trust for the State
   a. State v. Malone, 168 S. W. 2d. 292
   b. 689 county-maintained roads in DeWitt County
   c. 342 miles impacted by current Eagle Ford Shale activity in the wet gas window
II. Impacts of Drilling Activity on DeWitt County Roads
   a. Unconventional drilling methods create a tremendous strain on infrastructure
   b. Up to 270 loads of gravel to build a pad site and surface water pond
   c. Department of Motor Vehicle records indicate a typical rig move is as many as 25 vehicles with cumulative weight from 3.5 to 6 million lbs.
   d. TXDOT records from Barnett Shale reveal per well traffic equivalent to roughly 8 million cars to bring in the well plus an additional 2 million cars per year to maintain the well
   e. Naismith Engineering, Inc. commissioned in 2012 to study impact of Eagle Ford Shale drilling activity on the county road system:
      i. County roads are typically 4-6 inches of gravel base over soil and intended to carry local traffic in a right of way 60 foot wide or less.
      ii. Executive Summary is that anticipated oil field activities will require the construction of heavier and wider roads as follows: 45 miles of annual maintenance at $80,000 per mile; 187 miles of Basic Reconstruction at $920,000 per mile; and 99 miles of Major Reconstruction at $1,900,000 per mile
      iii. $432 million or $133,000 per anticipated well to provide a road system to serve the public, including the oil and gas industry.
III. Past, Present, and Projected Exploration Activity; Historical and Current Budget Appropriations for Road Maintenance vs. Needs
   a. 69 average wells per year in the last decade, 125 RRC permits in 2010, 355 RRC permits in 2011, and on track 375 in 2012

b. At 65 acre spacing, up to 3250 new wells projected
c. Dry gas region could add several thousand more wells in time
d. Road budget in 2003 = $1.6 million
e. Road budget in 2013 = $5.1 million (operating, maintenance, equipment needs only)
f. Up to $27 million annual maintenance only - ignoring construction needs

IV. Current Sources of Funding and Limitations
   a. State remittance of axle fees in FY 2012 = $75,669
   b. State remittance of axle fees in FY 2011 = $52,972
   c. Gasoline tax remittance approximately $30,000 per year
   d. Voluntary contracts ($8000 per well) expiring in December
   e. Ad Hoc donations
   f. Property taxes
      i. According to Property Tax Code Chapter 26, New Mineral Values added to the tax roll do not enjoy the same treatment as New Improvements (see Truth In Taxation Worksheet Line 21 exclusion)
      ii. Exponential growth in the tax base forces tax rates down by an inverse proportion and limits a county's ability to raise necessary taxes to offset damages without the threat of a Rollback Election
      iii. DeWitt County has raised taxes 57% in two years according to Truth In Taxation formulas
      iv. Volatile mineral values added to the tax roll in the current year are prone to reappraisal at 40 to 80 percent decline in the second year
      v. When drilling activity ceases, the mineral value decline is parabolic and triggers a parabolic rise in the property tax rates potentially triggering a Rollback Election
      vi. Rising tax rates will not impact the Over Age 65 and Disabled population
      vii. Timid or inattentive county officials will not risk a Rollback Election and therefore provide de facto tax abatements to the oil and gas industry at the same time maximum damage is occurring to the county road system
      viii. Additional public hearings, special advertising, and threats of a Rollback Election would not occur if Mineral Values were treated like Ne Improvements for purposes of Effective Tax Rate calculation
   g. Sub-surface easement negotiation
      i. DeWitt County has negotiated sub-surface easement and enjoyed monetary consideration on roads where the county owns the minerals but the State of Texas has negotiated an oil and gas lease
      ii. A huge cloud exists over the right to negotiate an easement but not a lease on the same tract of land
   h. Prohibition from assessing local trucking permits or fees if truck has paid for a statewide tolerance permit
   i. Administrative and logistical difficulty enforcing weights and measures locally
   j. Unable to lease county right of way and use the royalty to offset damages due to AG Opinion WW-870

k. State of Texas is Lessee on county right of way and state highways and received $1,973,000 in 12 month period ending May 2012 from DeWitt County production; more than $3 million received from Karnes County production in the same period
l. Severance Tax generated by production in DeWitt County and paid to Comptroller in FY 2011 was more than $57 million
m. Severance Tax generated from March to August 2012 by production from DeWitt County was more than $71 million
n. Twenty-four EFS counties generated $389 million in FY 2011
o. Twenty-four EFS counties generated $271 million in 6 months (Mar-Aug 2012)
p. Comptroller reports $3.6 Billion in Severance Tax receipts State FY 2012.
q. Rumors that Rainy Day Fund may exceed constitutional limit this biennium

V. Proposal- Allocation of Severance Tax to Petroleum Producing Counties to Pay for Damages, to wit:

"Be It Resolved that the Severance Tax is allocated 25% to the Permanent School Fund, 25% to the County where the production occurred, and 50% to the Economic Stabilization Fund."

VI. Proposal - Legislation Allowing Counties to Negotiate an Oil and Gas Lease on County-owned Right of Way, to wit:

"Be It Resolved that the County Judge of the County has the Authority to Negotiate an Oil and Gas Lease on county right of way behalf of the County and Be It Further Resolved that the bonus consideration and the royalty and rental payments be paid to said County in order to compensate for damages to said roads."

VII. Proposal- Define New Minerals Added to the Tax Roll as a Line 21 Exemption in the Effective Tax Rate Calculation, to wit:

"Be It Resolved that Mineral Values be defined in Chapter 26 of the Property Tax Code, and Be It Further Resolved that New Mineral Values be treated as if they were New Improvements for the purposes of calculating the Effective Tax Rate and Rollback Tax Rate with respect to Line 21 of the Truth In Taxation worksheet."

VIII. Exhibits

Conclusion

County governments in and around unconventional oil and gas Plays have been severely impacted by the damages done to the county road infrastructure and cannot maintain a safe environment capable of generating vast sums of revenue for the State of Texas without legislative changes which would fund the necessary repairs and construction costs.

A change in the allocation of the Severance Tax so that petroleum producing counties receive 25% for damages would achieve the dual goal of safety and promote a pro-business environment as well as meet the constraints of Governor Perry's Budget Compact by allocating dollars to pay for damages before the remainder is allocated to the Rainy Day Fund. The allocation would self-governing, in that the pace of drilling activity would either increase the dollars available for damages and construction at precisely the time the damages are occurring or reduce them when drilling activity declines and the potential for damages has decreased.

Statutory authority to negotiate an oil and gas lease on county right of way (where the county owns a fee-simple interest) would provide bonus consideration and royalty to offset the damages in the impact zone of the lease.

Treating New Minerals added to the tax base in the first year of appearance just like New Improvements are treated for the purpose of calculating the Effective Tax Rate would negate the necessity of advertising for and holding additional public hearings as well as relieve the ominous prospect of a referendum for a Rollback Election which can take up to 90 days after budget adoption to manifest itself and trigger an election. Additionally, county officials would not be perceived by the public as spendthrifts. And more importantly, in counties where the Overage 65 and Disabled Homestead Tax Exemption is in place, younger taxpayers and businesses would not bear a disproportionate share of future tax increases which invariably come when volatile mineral values deplete in parabolic degree.

These three changes would have provided DeWitt County with a potential supply of capital in the neighborhood of $19 million in the last fiscal year which would be 1/20th of the projected $432 million needs which were ascertained by its engineers, Naismith Engineering, Inc. in the study which is attached as an Exhibit and entered into the record of this committee.

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