SENATE TAXATION
EXHIBIT NO. 8
DATE 4-11-05
BILL NO. HB 535

320 South Illinois Street
Conrad, Montana 59425
Phone: 278-3191

November 23, 2004

Representative Llew Jones
1102 4th Avenue SW
Conrad, Montana 59425

RE: Stripper Oil Production Tax MCA 15-36-303(22) and 15-36-307(6)(c) HB 535

Dear Llew:

Of huge concern to the Montana oil industry is the oil production tax on stripper wells. When the price of West Texas crude as quoted in the Wall Street Journal averages $38 a barrel for a quarter, the oil production tax for Montana almost-1 to 3 barrel stripper wells goes from .75 percent to 12.8 percent. An example of the impact of that tax we have experienced: the tax of a previous quarter was $3,065. The following quarter was $21,000, when the average price in the Wall Street Journal was $38.3126. Then the price of oil dropped back down to the basement and the stripper producers were left, once again, in the hole. As shown in the enclosed "Crude Oil Price Bulletin Summary", the price for Pondera oil never reaches the Journal quote. It is now, always 9.50 to 10 dollars less. We are taxed for dollars we never receive.

We strongly need to have this ceiling of $38 West Texas Crude as quoted in the Journal, or anywhere else, and the 12.8 percent on almost-1 to 3 barrel stripper wells eliminated. We can continue in business, if the tax remains AT ALL TIMES no more than the incentive tax of .75 percent.

People not in the oil industry see the price of oil in the papers, hear it in the news and think the oil people are making a huge profit. The fact is, the price of oil is decided by a lot of factors: the gravity of the oil, speculation on the futures market, world events, natural disasters, NAFTA etc.; therefore, the price fluctuates all the time and can go from $50 a barrel to $9 a barrel in a very short time.

Our profit comes after refinery and transport charges, royalties, taxes and the overhead of keeping up old wells. The first well in the Pondera Oilfield was drilled by my Dad, Ted Hawley, in 1927 and these, now-old-wells have produced until they make only almost-1 to 3 barrels a day. The cost of supplies has skyrocketed, the price of steel doubled, competition of oil service and supply companies has evaporated, all costs have gone up, so the cost of keeping the wells going is very high.

Hawley-Desimon Inc. had to turn a producing oil well into a water input well at the cost of over $14,000. That well is no longer a producer. The wells are making more water and less oil and we have to put the water back into the ground, because of EPA regulations. Other producers do the same.

The politicians don't take in consideration:

1. The refinery takes out 9.50 to 10 dollars a barrel
2. Trucking oil to refinery
3. Royalties
4. EPA expense
5. Taxes besides production tax
6. Well and equipment maintenance
7. High cost of equipment and labor
8. Insurance

The stripper oil producers are still reeling from the last depression in oil prices. Many of our equipment and maintenance suppliers are no longer in business, because we couldn't afford to use them. No government program came to our rescue!

Cut Bank is a good example of what such high oil taxes have done to the economy of Montana. Cut Bank has lost a lot of its income, people and businesses, because of the collapse of the oil industry. The collapse was due to the last few years, when oil price was so low and then the high tax when the price did go up. Lose the oil industry and Montana loses a huge group of consumers and "reasonable" taxpayers.

In the Pondera Field, some locations could be drilled, but the cost is too prohibitive, when producers are never given the opportunity to accumulate enough income. Instead of drilling new wells, old, producing wells are being abandoned. (Higher prices make possible drilling, however, drilling doesn't always produce a well…so, further expense.)

We can weather the storm of low oil prices and the overhead, because the market does send prices up for awhile. But, when the price goes up for a quarter, the 12.8 percent tax comes in and then the next quarter the price of oil goes down and then <u>way</u> down, the result is a crippled industry. Isn't it better for the state to get .75 percent on these almost one to 3 barrel stripper wells than nothing at all? Montana has a history of driving small business out of the state, which affects our schools and every aspect of our economy.

The national TV news reported in November that Colorado is having a new awakening due to the activity of wells being drilled and old wells reactivated. Sleepy, nearly-ghost towns are coming alive and the people are excited. The price of oil is making it possible for producers to drill and startup shutdown wells. Oil prices will go back down again, but the new wells will help the state and the producers.

Montana can't see this growth, because the producers are never given a chance to drill new wells nor reactivate wells that were shut down, because they were too expensive to run when the price of oil was so low.

I talked with the Cenex refinery manager in charge of the price the producer is paid for oil. He said he used to be a producer, but because of all I mentioned above, he couldn't make it and now is working for Cenex. He told me that we might think of just shutting down and doing something else. Would that be all that good for Montana and Pondera County, to lose the stripper oil industry: the producers, suppliers, service people all moving to other states to find a living? Why stay here when we have been robbed of our livelihood? The domino affect would cost far more than what would be gained by this 12.8 percent tax until it costs us our business and then no tax at all from us....we are gone.

We oil producers would appreciate you spreading the word to other Montana congressmen/women and commissioners about the need to drop this destroying tax of 12.8 percent for almost-1 to 3 barrel wells on any price of oil... no matter how high. Commissioners and congressmen/women of counties that don't have oil think that since the oil people are removing resources and are glutted with such high profits, they should have to pay for Montana. Montana has made billions off the oil industry and that is fine. We aren't opposed to taxes, just destroying taxes that destroy our incentive and ability to produce oil.

The people of the United States believe the price of oil is the sole factor in the price of gasoline. Gasoline price is determined by federal and state law decisions for tax added. (John Kerry wanted to add another tax of 50 cents a gallon.) They decide what additives and what taxes to impose per gallon per state. In 1981 the country had 324 operating refineries; today there are 149 and they can't keep up with demand. (Reason? Hefty environmental costs and too much government regulation and delay) those factors are added to the price of the oil. The oil producers must receive dollar-per-barrel equal to inflation or they can't continue to operate............the same as with all other businesses.

The Great Falls Tribune reported, February 7, that North Dakota oil-drilling rigs are heading to eastern Montana. Lynn Helms, North Dakota's Oil and Gas Division director, said the state of North Dakota charges a 12.5 percent tax for each new well that is drilled. "That same new well in Montana is taxed 1.5 percent for the first two years and then it jumps to 9.5 percent." He further said, "An 11.5 percent tax is unhealthy for any industry, in any situation."

Why is Montana taxing almost-1 to 3-barrel stripper oil producers out of business? Why is Montana taxing so unreasonably these little wells at 12.8 percent and on money we never see? Why does it just grab a figure out of the air and then decide that 12.8 percent is a good figure. These old fields to survive should be left at .75 percent...period. We can survive on that, stay in Montana, set aside for our families and help build Montana.

This letter is long, but not as long as we oil people want to stay in the oil industry and in Montana.
Very sincerely,

Lois H. Miller, Secretary Hawley-Desimon, Inc.

(505) 748-3311 Artesia, New Mexico 88211-0159 (505) 746-5419

CRUDE OIL PRICE BULLETIN SUMMARY - JUNE 2004

Effective 7:00 a.m. on the date(s) shown and subject to change without notice, and subject to the applicable rules and regulations of all governmental authorities and to the provisions of its Division Order and/or contractual agreements Montana Refining Company will pay the following prices per barrel of 42 U.S. gallons of merchantable crude oil and condensate purchased by it from the area designated below and delivered for its account into the custody of an authorized receiving agency; provided, however, that any transportation or handling charges required or imposed to move said crude oil or condensate from lease tanks to a pipeline terminal may be deducted. Merchantable crude oil and condensate is defined as virgin crude oil and/or condensate as produced from wells, free of added chemicals and contaminates and suitable for normal refinery processing. Seller warrants that the crude oil and condensate delivered to Montana Refining Company shall be of merchantable quality as defined above. The prices posted below are for 40.00 degree API gravity and above are based upon computation of volume by the use of 100% tank tables or mutually acceptable automatic measuring equipment with deductions in full for all basic sediment and water and corrected for temperature to 60 degree F., in accordance with usual industry practice.

AREA: Montana: All fields in Glacier, Liberty, Pondera, Teton, and Toole Counties.

BULLETIN NUMBER	EFFECTIVE DATE	Wall Street Jornal Price	PRICE/BBL	Pondera Price	Jan 2005 3 pread
92-2004	June 1, 2004		$38.00		
93-2004	June 2, 2004	40.10	$35.75	34.985	29.985
94-2004	June 3, 2004		$35.00		
95-2004	June 4, 2004	38.60	$34.25	33.46	28.46
96-2004	June 7, 2004		$34.50		
97-2004	June 8, 2004		$33.00		
98-2004	June 9, 2004	37.55	$33.25	32.43	27.43
99-2004	June 10, 2004	38.20	$34.25	33.43	28.43
100-2004	June 14, 2004		$33.25		
101-2004	June 15, 2004	37.18	$33.00	32.21	27.21
102-2004	June 17, 2004		$34.25		
103-2004	June 18, 2004	38.48	$34.50	33.71	28.71
104-2004	June 21, 2004		$33.25		
105-2004	June 22, 2004	38.13	$33.75	32.97	27.97
106-2004	June 23, 2004		$33.25		
107-2004	June 24, 2004		$33.75		
108-2004	June 25, 2004	37.15	$33.25	32.44	27.44
109-2004	June 28, 2004		$32.00		
110-2004	June 29, 2004	35.93	$31.50	30.72	25.72
111-2004	June 30, 2004		$32.75		

AVERAGE $33.8750

Gravity Adjustment:

Montana Department of Revenue

Don Hoffman
Acting Director

Judy Martz
Governor

IMPORTANT

ELIMINATION OF OIL INCENTIVES FOR 2nd QUARTER 2004

According to MCA 15-36-303(22) and 15-36-304(6)(c), if the average price of west Texas intermediate crude oil is equal to or greater than $30 a barrel for stripper oil or more than $38 a barrel for the stripper exemption, then some existing oil incentives are eliminated for that quarter. "The average price for a barrel is computed by dividing the sum of the daily prices for west Texas intermediate crude oil as reported in the Wall Street Journal for the calendar quarter by the number of days on which the price was reported in the quarter." The oil incentives eliminated include reduced tax rates for stripper oil, stripper exemption, incremental secondary production and tertiary production.

The average Wall Street Journal price for the quarter ending June 30, 2004 is **$38.3126**, which exceeds the benchmarks for the above mentioned oil incentives. The tax rates for stripper oil, stripper exemption, incremental secondary production, and tertiary production for second quarter 2004 working interest owners will be:

Pre-1999 wells	12.76%
Post-1999 wells	9.26%

This means that all oil leases that would normally have been filed on the O-STRIP or OSTRX2 schedules for the quarter ended 6/30/04 will need to be filed on the O-REG schedule. The only oil production that can be reported on the ENH-INCR schedule would be the recompleted horizontal 0-18 months. The secondary and tertiary oil production for the quarter ended 6/30/04 must be reported on the O-REG schedule.

The non-working interest owner or royalty tax rate of 15.06% is not affected by the elimination of oil incentives.

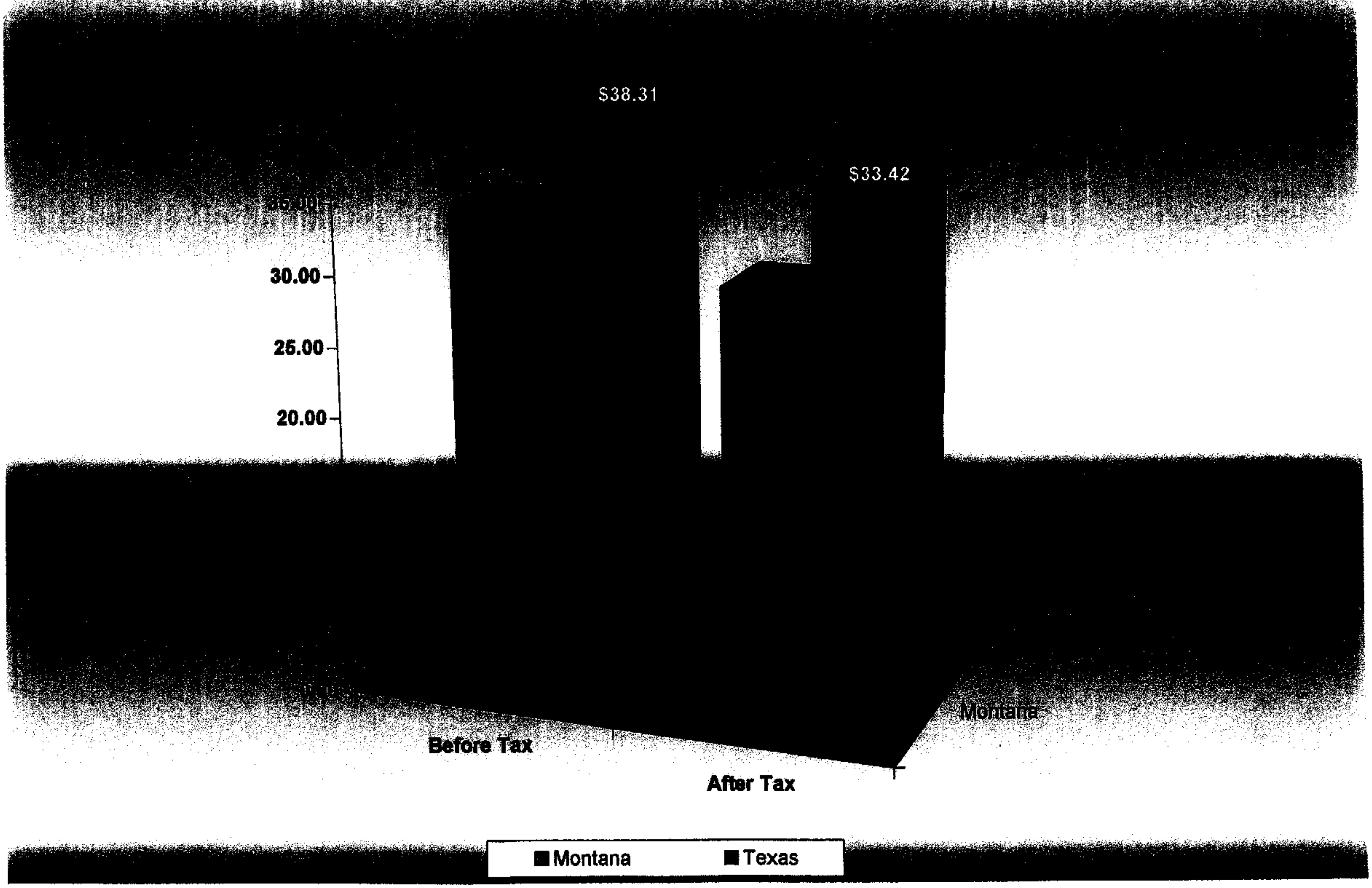
The Montana Code Annotated is available on the Department of Revenue Internet site, at http://www.state.mt.us/revenue/, under For Your Reference. The average price for the west Texas intermediate is at the above site under For Business/ Taxes, Licenses, Fees and Permit/Natural Resource Taxes

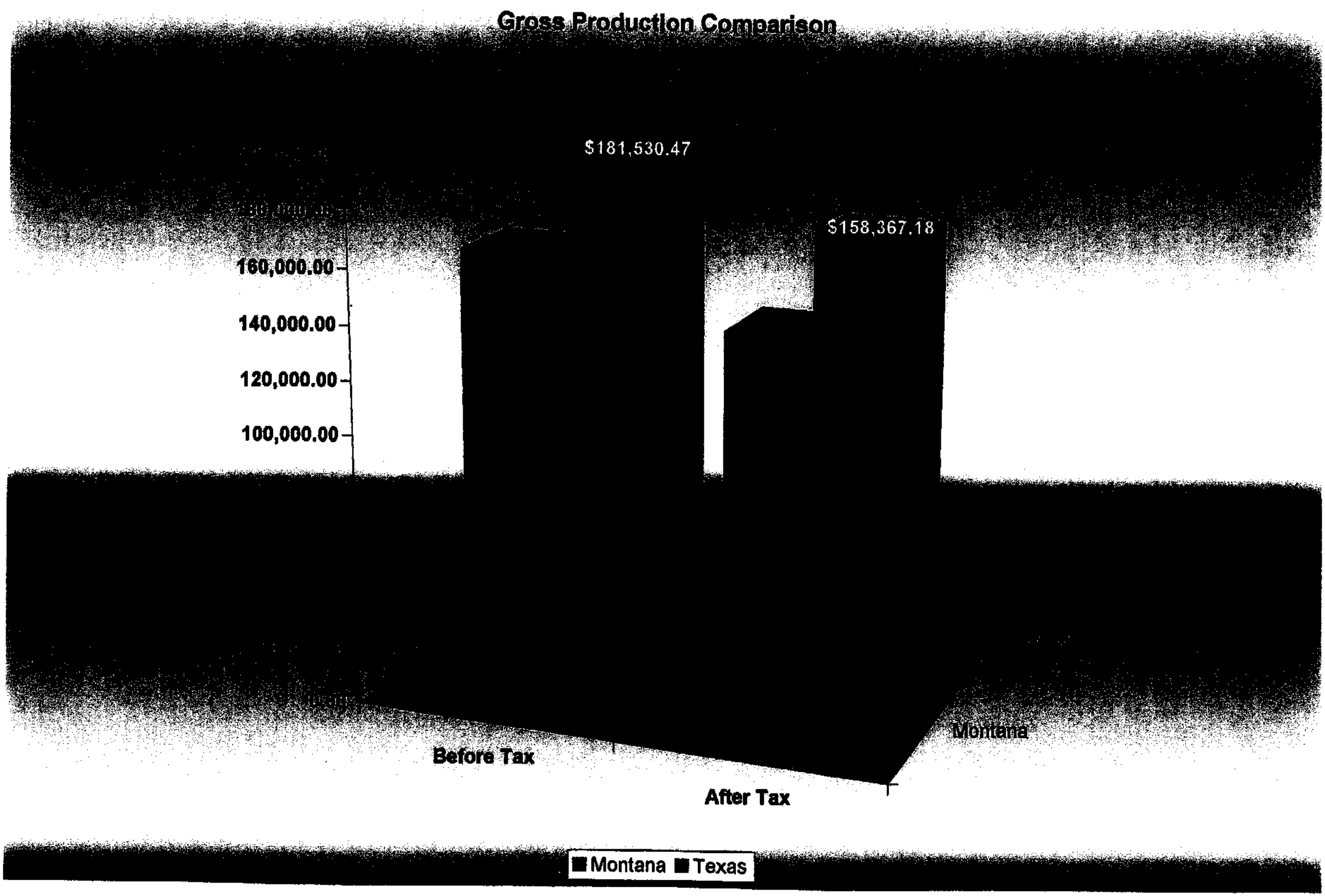
Our accountant made the enclosed charts. One chart shows the price received per Barrel comparison. The other chart shows the dollar amounts received and a "Texas" estimate.

What she did is take the actual scenario that happened with a 2^{nd} quarter for the Montana numbers. She then took the price that was received per Barrel average in Texas and created a scenario that would have happened had Montana received the benchmark average of 38.31 dollars.

An interesting note – we would have made the same amount of net after oil taxes had the price per Barrel that we received been 30.33 and the benchmark in Texas not made.

Price per Barrel Comparison





Gross Production Comparison
$181,530.47
$158,367.18
160,000.00
140,000.00
120,000.00
100,000.00
Before Tax
After Tax
Montana
Montana
Texas