GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Fiscal Note 2025 Biennium

Bill information:	
HB0634 - Generally revise oil and gas laws (Kassmier, Joshua)	
Status:	As Introduced

☐Significant Local Gov Impact ☐Needs to be included in HB 2 ☒Technical Concerns

☐Included in the Executive Budget ☒Significant Long-Term Impacts ☐Dedicated Revenue Form Attached

FISCAL SUMMARY

	FY 2024 Difference	FY 2025 Difference	FY 2026 Difference	FY 2027 Difference
Expenditures:				
General Fund	$933	$2,177	$3,421	$4,665
State Special Revenue	($933)	($2,177)	($3,421)	($4,665)
Revenue:				
General Fund	$0	$0	$0	$0
State Special Revenue	($933)	($2,177)	($3,421)	($4,665)
Perm Fund (09)	($21,122)	($49,285)	($77,448)	($105,611)
Net Impact-General Fund Balance:	($933)	($2,177)	($3,421)	($4,665)

Description of fiscal impact: HB 634 would allow oil and gas producers to deduct expenses for transportation, compression, and associated costs from the gross value of the oil or gas produced for royalty calculation purposes. HB 634 would revise the royalty clause which would result in a reduction of royalty revenue for the school trust. The common schools trust would be the most impacted trust by HB 634 and would experience a reduction in permanent fund revenue and subsequent distributable interest to the guarantee account.

FISCAL ANALYSIS

Assumptions:

Department of Natural Resources and Conservation

1. HB 634 does not contain an effective date. The bill will become effective on October 1, 2023.
2. Existing royalty provisions require payment free of costs and deductions to the point of sale (i.e., to the point where oil or gas production is delivered to the credit of the lessee). This is referred to as gross proceeds lease.

3. Section 4 of HB 634 does not clarify whether costs of production, as defined in Section 1, are incorporated in 77-3-434 (1), MCA, for cash royalty payments. It is assumed that cash royalty payments are impacted by HB 634 (see Technical Note 1).
4. Beginning in FY 2024, state school trust oil and gas leases issued by the Board of Land Commissioners (Land Board) will be required to allow deductions from gross value, including costs associated with transporting oil or gas to market and compression, for royalty calculation purposes. Adjustments for oil gravity, BTU (British thermal units) content and pressure differential are also included, but these are already recognized in state lease royalty calculations. The royalty rate would remain at 16.67%.
5. The Department of Natural Resources and Conservation (DNRC) will issue approximately 169 new oil and gas leases per year, equivalent to the average number of leases issued over the most recent five-year period.
6. Over the long term, an average of 3.09% of new leases issued will be productive for oil and/or gas, based on currently productive leases relative to total leases issued by DNRC.
7. Oil and gas prices for FY 2024 through FY 2027 are estimated to average $88.00/bbl and $4.79/mcf, respectively (bbl = barrel; mcf = 1,000 cubic feet).
8. Average annual new production from state school trust oil and gas leases over the past ten years is 4,535 barrels of oil and 6,204 mcf of gas per lease.
9. An analysis of information gathered from audit assessments containing gas deductions for compression and transportation results in an estimated average deduction of $0.80/mcf for gas, with a range of $0.17/mcf to $1.89/mcf.
10. An analysis of information gathered from audit assessments containing oil deductions for transportation results in an estimated average deduction of $6.04/bbl, with a range of $2.76/bbl to $14.30/bbl.
11. Using the average estimated deductions for compression and transportation produces a loss to royalty revenue of $5,393 per producing lease per year.
    - Oil: ($6.04/bbl) x (4,535 bbl) x (16.67%) = $4,566
    - Gas: ($0.80/mcf) x (6,204 mcf) x (16.67%) = $827
12. Total fiscal impact from compression and transportation deductions from gross value would be $28,163 per year (169 leases x 3.09% x $5,393 per producing lease) .
13. The common schools trust will be the most impacted with a loss of permanent fund revenue and subsequent reduction in distributable interest to the guarantee account.
14. The total estimated loss from gross royalty over the FY 2024 through FY 2027 forecast period from leasing an average of 169 new leases summarized in the following table (the October 1, 2023 effective date reduces the FY 2024 fiscal impact, assuming some leases will be issued before the effective date).

Fiscal Impact of HB 634

	FY 2024	FY 2025	FY 2026	FY 2027
FY 2024 Leases	$21,122	$21,122	$21,122	$21,122
FY 2025 Leases		$28,163	$28,163	$28,163
FY 2026 Leases			$28,163	$28,163
FY 2027 Leases				$28,163
Total	**$21,122**	**$49,285**	**$77,448**	**$105,611**
Foregone Interest Earnings to Guarantee Account	$933	$2,177	$3,421	$4,665

15. The yield on common schools permanent fund investments is project to average 4.65% for FY 2024 through FY 2027. Five percent of the interest is reinvested in the permanent fund and 95% is distributed to the common schools guarantee account.

16. Reductions to the common schools guarantee account reduce the funding for K-12 base aid. It is assumed that the general fund will offset the reduction in the guarantee account.

	FY 2024 Difference	FY 2025 Difference	FY 2026 Difference	FY 2027 Difference
Fiscal Impact:				
Expenditures:				
Local Assistance K-12 Base	($933)	($2,177)	($3,421)	($4,665)
General Fund Exp Offset	$933	$2,177	$3,421	$4,665
TOTAL Expenditures	$0	$0	$0	$0
Funding of Expenditures:				
General Fund (01)	$933	$2,177	$3,421	$4,665
State Special Revenue (02) CS	($933)	($2,177)	($3,421)	($4,665)
Perm Fund CS (09)	$0	$0	$0	$0
TOTAL Funding of Exp.	$0	$0	$0	$0
Revenues:				
General Fund (01)	$0	$0	$0	$0
State Special Revenue (02) CS	($933)	($2,177)	($3,421)	($4,665)
Perm Fund CS (09)	($21,122)	($49,285)	($77,448)	($105,611)
TOTAL Revenues	($22,055)	($51,462)	($80,869)	($110,276)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	($933)	($2,177)	($3,421)	($4,665)
State Special Revenue (02)	$0	$0	$0	$0
Perm Fund CS(09)	($21,122)	($49,285)	($77,448)	($105,611)

Long-Term Impacts:

1. The forecast above depicts fiscal impact from new leases through FY 2027. As new leases subject to HB 634 continue to be issued and old leases expire, the fiscal impact will continue to increase. Using a five-year average of total production between FY 2018 and FY 2022, and assuming virtually all the production coming from new leases, the total impact could amount to approximately $1,350,000 per year.
   - Oil: ($6.04 per bbl) x (1,019,185 bbls) x (16.67%) = $1,026,185
   - Gas: ($0.80 per mcf) x (2,391,268 mcf) x (16.67%) = $318,900

Total royalty revenue under current law between FY 2018 and FY 2022 averaged $8.75 million per year. The potential royalty lost from HB 634 therefore represents a 15% reduction.

Technical Notes:

1. Subject to the ambiguity noted in Assumption 3, DNRC interprets HB 634 as applying only to new oil and gas leases issued after its effective date. The basis for this interpretation is that the existing leases cannot be altered by subsequent legislation that would impair obligations arising under the lease contract. If a court were to rule that HB 634 applies to all production from both existing and new state school trust leases, the full fiscal impact of about $1,300,000 per year would be immediate.
2. Subject to the ambiguity noted in Assumption 3, the definitions contained in Section 1 eliminate Land Board management authority to determine appropriate royalty calculation standards in state oil and gas leases.

3. Section 3 eliminates Land Board management discretion to determine whether it is in the best interest of the state school trust to share in the expense of transporting oil to market. The language in Section 4(2) seeks to change royalty language that has been a part of state school trust oil and gas leases since at least 1938.
4. Montana case law recognizes the lessee/producer's obligation under a state oil and gas lease to market oil and gas production, free of costs and deductions. (Department of State Lands v. Balcron Oil Company, Mont. Ninth Jud. Dist., Pondera Co. Case No. DV-88-23 (Sept. 11, 1990)
5. Royalty audits would be more complex under HB 634. The lessee/producer would be providing, and the department's royalty auditor would have to analyze records for costs deducted to determine their accuracy and consistency with the contractual terms of each deduction. For deductions generated from lessee/producer's activities, the auditor would be analyzing records applicable to the allocated deduction amount. These amounts are self-generated by the lessee/producer and may include cost and depreciation of capital and rate of return. DNRC noted wide variations in amounts reported by lessee/operators for compression and transportation. HB 634 does not provide guidance on treatment of records created by the lessee/producer for deductions, or the recognition of capital depreciation and rate of return.

JK	2-27-23		2-27-23
Sponsor's Initials	*Date*	*Budget Director's Initials*	*Date*