Oil Price Decline and Weak Production Results Should End Kasich's Severance Tax Hike Plan

January 12, 2015
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With the release of the production figures for the 3rd Quarter, any discussion of increasing the severance tax on Ohio's energy entrepreneurs, farmers, and landowners should end. This outcome is even more critical given the plummeting price of oil, which will negatively impact exploration and investments – especially in weaker shale plays like Ohio.

Evidence the slowdown is already underway hit on January 7, 2015, when the Wall Street Journal reported that 614 steelworkers in Lorain who manufacture steel pipes and tubes for oil and gas activities received layoff notices.[1] Likewise, the Akron Beacon Journal reported that Antero Resources is laying off 250 contract land brokers.[2] Additional layoffs will result from these layoffs.

It is critical to put Ohio's energy production in perspective. According to Baker Hughes Rig Count, there are currently 46 drilling rigs in Ohio, as there are 839 in Texas, 209 in Oklahoma, 169 in North Dakota, 109 in Louisiana, and 53 in Pennsylvania.[3] There simply is more oil (and gas) in other states, as well as other countries.

More importantly, according to the U.S. Energy Information Administration, the Utica Shale oil production numbers compared to the Permian, Eagle Ford, and Bakken formations are insignificant.[4] Ohio's production represents roughly 0.3% of the total U.S. daily production of 9 million barrels of oil. Specifically, the Utica formation is producing less than 33,000 barrels of oil per day compared to more than 1.2 million in the Bakken formation, 1.6 million in the Eagle Ford formation, and nearly 2.0 million in the Permian formation.[5] Ohio is and will remain a marginal source of oil.

We focus on oil production because gross income from oil production made up 95.8 percent of the revenue from which Governor John Kasich expected to get his severance tax proceeds.[6] Everyone knows Governor Kasich is desperate to find sources from higher taxes to fund continued personal

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1 John W. Miller, "U.S. Steel Idles Plants on Oil Impact," Wall Street Journal, January 7, 2015, B1.

2 Bob Downing, "Antero Resources to Lay Off 250 Contract Land Brokers," Akron Beacon Journal, January 6, 2015, available at http://www.ohio.com/blogs/drilling/ohio-utica-shale-1.291290/antero-resources-to-lay-off-250-contract-land-brokers-1.555689.

3 Baker Hughes, "Baker Hughes U.S. Rig Count Reports," undated, available at http://gis.bakerhughesdirect.com/Reports/.

4 U.S. Energy Information Administration, "Drilling Productivity Report: Year-Over-Year Summary," undated, available at http://www.eia.gov/petroleum/drilling/pdf/summary.pdf.

5 Id.

6 Governor Kasich's projections are contained in a document his administration produced titled, "Estimated New Severance Tax Revenue and Gross Production Income (2012-2016)." A copy of this document is on file with the author.

income tax reductions, but hiking taxes on Ohio's energy industry at such a precarious time will inhibit future investment and production in Ohio. Given the more than 20 percent growth in state spending during his first term, any further reductions in the personal income tax should come from reductions in state spending in the next budget.

Governor Kasich's original estimates are contained in Table 1 below. His original estimate for 2012-2014 projected that the severance tax would raise $190,942,414. That estimate depended on three key factors: (1) the number of producing wells would be at a certain level, (2) each well would produce a specific number of barrels, and (3) oil would sell at $90.00 per barrel.

Based on the production figures over nearly three years from the Ohio Department of Natural Resources and the drop in oil prices, it is clear Governor Kasich's original estimates were overly optimistic.[7] We previously explained the flaw in hiking the severance tax in "Governor John Kasich's Claims on His Severance Tax Hike Plan: 'Exorbitant Overestimates' Drive Bad Policy" and "Time for Governor John Kasich to End His Severance Tax Hike Gamble."[8]

With the most recent production data, it makes even less sense now to hike the severance tax. As contained in Table 2, using the actual well count, the current price of oil, and Governor Kasich's production decline estimate based upon the average daily production as prorated using the 3rd Quarter production results from the 595 active wells in Ohio, Governor Kasich's original severance tax proposal of 1.5 percent would have provided just $14,099,681 in severance tax funds from 2012 to 2014. Even if we use a higher flat 4.0 percent tax rate over the five years, the severance tax only yields $34,141,742, which is just 17.9 percent of Governor Kasich's $191 million original estimate. Those amounts don't reflect the roughly $12.5 million in annual regulatory costs that get paid before funds are generally available, wiping out any revenue for personal income tax cuts.[9]

The number of wells (595 versus 925) and the average production of those wells (89,100 versus 29,605) are not close to Governor Kasich's original estimate and the price of oil is now below $50.00 per barrel (versus $90,00). Table 3 contains Governor Kasich's estimates compared to the actual data from 2012 to 2014.

The bottom line is that Ohio is not a strong oil play. With the price of oil declining, the marginal attractiveness Ohio held for energy companies is also declining. There is a reason BP, Shell, Devon, Anadarko – all top energy companies – and several smaller independent oil companies, have left Ohio. Governor Kasich's mantra that raising the severance tax didn't matter because the energy companies wouldn't have anywhere else to go has proved false. Raising taxes in this kind of environment given the weak returns simply doesn't make sense.

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[7] Ohio Department of Natural Resources Division of Oil & Gas Resources, "Oil & Gas Well Production," undated, available at http://oilandgas.ohiodnr.gov/production.

[8] Matt A. Mayer, "Governor John Kasich's Claims on His Severance Tax Hike Plan: 'Exorbitant Overestimates' Drive Bad Policy," Opportunity Ohio, August 23, 2012, available at http://www.opportunityohio.org/wp-content/uploads/2012/06/Kasich%E2%80%99s-Claims-on-His-Severance-Tax-Hike-Plan.pdf; Matt A. Mayer, "Time for Governor John Kasich to End His Severance Tax Hike Gamble," Opportunity Ohio, May 20, 2013, available at http://www.opportunityohio.org/wp-content/uploads/2013/05/Time-for-Governor-John-Kasich-to-End-His-Severance-Tax-Hike-Gamble.pdf.

[9] Table 2 is to illustrate impact of actual results at $50.00 per barrel going forward using 2012 to 2014 data.

Moreover, Governor Kasich's threat of a statewide ballot initiative is nothing more than a progressive attempt to drive the tyranny of the majority to tax a minority of Appalachian Ohioans and their employers. Ohioans deserve better than this kind of "us versus them" politics.

We hope the Ohio General Assembly remains firm in its stance to oppose changing the current severance tax. If the energy industry is as overleveraged in debt as reports suggest, we will see an increase in energy company bankruptcies, more job losses across the energy industry, and lower exploration and production in Ohio. In such uncertain times, the best play is the conservative one.

Table 1: Governor John Kasich's Original Prediction for Estimated New Severance Tax Revenue and Gross Production Income (2012-2014)

Annual Production Per Well (barrels)	2012	2013	2014
89,100	172 wells	559	925
62,100		172	559
48,600			172
40,500			
34,200			
Total Production	7,662,600	35,584,650	84,281,850
Gross Income at $90/BBL	$689,634,000	$3,202,618,500	$7,583,361,750
Estimated Severance Tax Revenue	$10,344,510	$48,039,278	$132,558,626
		Total Severance Tax Revenue	$190,942,414

Table 2: Governor John Kasich's Original Model with Actual Results at $50.0 per Barrel

Annual Production Per Well (barrels)	2012	2013	2014
29,605	76 wells	265	254*
20,634		76	265
16,148			76
13,457			
11,364			
Total Production	1,124,990	5,490,830	10,455,051
Gross Income at $50/BBL	$56,249,500	$274,541,519	$522,752,532
Estimated Kasich Original Proposal Severance Tax Revenue	$843,743	$4,118,123	$9,137,815
		Total Severance Tax Revenue	$14,099,681 (7.4%)
Estimated Flat 4.0% Severance Tax Revenue	$2,249,980	$10,981,661	$20,910,101
		Total Severance Tax Revenue	$34,141,742 (17.9%)

Table 3: Governor John Kasich's Estimates Versus Actual Results

	Kasich Estimate of Producing Wells	Actual Producing Wells	Kasich Estimate of Production (Barrels)	Actual Production (Barrels)
2012	172	76 (44%)	7,662,600	635,874 (8.3%)
2013	731	341 (47%)	35,584,650	3,678,734 (10.3%)
2014 (Q3 Annualized)	1,656	595 (36%)	84,281,850	12,054,664 (14.3%)*

* Based upon 2014 third quarter production figures.