

Before the

**128th General Assembly
Ohio Senate
Environment and Natural Resources Committee
The Honorable Tim Schaffer
Chair**

Proponent Testimony on:

Senate Bill 165

Presented by:

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Executive Vice President
Ohio Oil & Gas Association
Granville, Ohio**

October 21, 2009



Chairman Schaffer, Ranking Minority Member Morano and members of the Senate Environment and Natural Resources Committee, thank you for the opportunity to offer proponent testimony in support of Senate Bill 165.

I am Tom Stewart and I serve as the executive vice president of the Ohio Oil & Gas Association (OOGA), a trade association whose 1,500 members explore for, develop and produce Ohio's crude oil and natural gas resources.

S.B. 165 addresses issues that are being debated in Ohio regarding the development and production of Ohio's crude oil and natural gas resources. The proposal relies on negotiations that have taken place over the past year between Senator Niehaus, the Ohio Oil & Gas Association, ODNR Director Sean Logan and the professional staff of the ODNR Division of Mineral Resources Management (DMRM).

Industry Description:

S.B. 165 amends Ohio law that regulates the ultimate upstream oil and natural gas exploration and production industry. All Ohio producers are "independent" producers - defined as a nonintegrated company which receives nearly all of its revenues from production at the wellhead. Independents are exclusively in the exploration and production (E&P) business. Nationally, the average company size is twelve employees.

Independent producers are the people who are developing America's oil and gas resource base. Independent producers drill 90 percent of domestic oil and natural gas wells, produce 85 percent of America's natural gas and 68 percent of American crude oil - more oil if the survey did not include Alaskan North Slope oil production. Recent studies show that these producers invest close to 150% of their wellhead cash flow back into the ground to replace American oil and gas reserves.

The focus of S.B. 165 is on drilling activity and operations. Critics of Ohio activity lament that drilling and production activity occurs predominately in one isolated area of the state. That characterization is not accurate.

Over our industry's history 274,733 wells have been drilled in Ohio (**Fig. 1**). Across all of Ohio the drill bit has tested oil and gas reservoirs at depths ranging from less than 100 feet to over 11,500 feet. An Ohio well spot map clearly shows that drilling activity has occurred throughout Ohio and heavily in 3 out of 4 quadrants (**Fig. 2**). Over time, the Ohio industry has produced over 1 billion barrels of crude oil and over 8.3 trillion cubic feet of natural gas.

Eastern Ohio lies on the upslope of the Appalachian Geosyncline and has attracted the lion's share of Ohio activity in recent times. Even so, during the modern post-regulatory period, wells have been drilled in all but nine Ohio counties (**Fig. 3**). During that period Muskingum County has dominated other counties as the top-drilled county.

It is not true that Ohio drilling activity occurs predominantly in urban areas. For each of the past four years the top-drilled county has been Monroe County (**Fig. 4**). And since H.B. 278 was enacted, urban permits on average account for only 25 percent of permits issued.

Oil and gas drilling activity is a rational process driven by economics and geologic opportunity. Nature is the ultimate guiding force. Producers drill wells where rational risk taking dictates that investment in a prospect will yield a reasonable economic return.

Critics claim that Ohio receives minimal economic benefits from oil and gas exploration and production and is not worth the effort. From what I've observed, people saying such things have property that does not produce energy or a royalty. The bottom line is that last year Ohio

producers delivered over \$202 million in royalty income to Ohio landowners that was pumped back into the Ohio economy.

Ohio-produced oil and natural gas is a huge benefit to Ohio consumers and businesses. It requires no subsidies, mandates or taxpayer support to be an effective energy tool for Ohioans. Locally produced crude oil and natural gas is an economic hedge against price disruptions in the energy market, such as hurricanes or wars, enhances consumer reliability and reduces price volatility.

A recent independent economic study found that Ohio receives the following benefits from locally produced crude oil and natural gas.¹

Jobs: Our industry produces 14,400 jobs (4,000 direct and 10,400 indirect jobs).

Personal Income: Our industry is responsible for \$730 million per year in personal income.

Consumer Impact: Locally produced crude oil and natural gas.....

- Keeps over \$1 billion per year in the state of Ohio.
- Saves Ohioans \$60 million per year in avoided interstate pipeline costs, and
- Saves Ohio consumers \$5 million per year due to the price reducing impact of having local natural gas supplies compared to sources from other parts of the country.

Industry Reinvestment: Last year, our industry reinvested approximately \$281 million for the exploration and development of new wells, accounting for \$707 million in gross state product.

Tax Revenues: Ohio crude oil and natural gas producers pay a total of \$57.5 million per year in federal, state and local taxes, which includes:

- \$2.6 million per year in severance taxes
- \$2.1 million per year in property taxes
- \$2.8 million per year in commercial activity taxes (CAT)
- \$40 million per year in federal income taxes
- \$10 million per year in state and local taxes

Gross State Product: Our industry generates approximately \$1.5 billion per year in gross state product with statewide sales of \$3.1 billion per year.

Despite the long-established record of the Ohio oil & gas industry, there is always room for improvement. I know that the environmental and social track record is solid in light of the vast amount of activity experienced in this state. No matter where a well is drilled there are risks associated with creating a hole in the ground and exposing a reservoir to production. That is why Ohio relies on regulation by experts. New issues will always emerge and be debated. Rational people will raise legitimate concerns. A rational industry will engage in responsible solutions. That is why S.B. 165 is before you today.

Senate Bill 165 represents the most significant revision to Ohio's oil and gas law since Amended Substitute House Bill 501 was enacted in December 1984 and may be the most comprehensive amendment to O.R.C. 1509 since the chapter was created in 1965. The legislative objectives are:

- To address present-day health, safety and social issues related to oil and gas development.

¹ "Ohio's Natural Gas and Crude Oil Exploration and Production Industry – Economic Impact Study", January 2008, Kleinhenz & Associates, Cleveland, Ohio

- Provide to the regulatory agency the funding resources necessary to administrate an effective enforcement program – particularly in light of concerns some have raised within urban situations.
- Ensure public faith and trust in the state oil and gas regulatory program.

The legislative proposal has three components:

1. The first component seeks a funding solution to adequately support the Ohio oil and gas regulatory program. The Association’s core principle was to negotiate improved funding directly based on proven regulatory need and not tied to gross production value or the economic fortune of risk-takers. The proposal will raise the DMRM oil and gas regulatory program budget from the current \$3.5 million to \$7.1 million.
 - The funding component is necessary to assure the public that the state regulatory agency has adequate resources to provide field inspections of drilling and production sites, perform quality review of permit applications, verify well construction procedures and efficiently carry out enforcement actions.
 - The funding methods evaluate existing fees and adjust them to meet actual regulatory costs; identifies regulatory burdens for which there is no existing support and imposes a fair fee; and creates a minor extraction fee to cover the remaining regulatory need on a broad basis. The total funds raised are dedicated to the oil and gas regulatory program and includes \$1 million in funds dedicated to the plugging of idle and orphan wells (another national issue).
 - The Association agreed to the funding proposal after the Administration decided to remove the “oil and gas energy extraction fee” from H.B.1 during House consideration of the biennium budget bill. That fee proposal was essentially a gross receipts tax that if enacted would have potentially extracted nearly \$27 million from the industry when combined with existing taxes and fees. The S.B. 165 fee proposal saves the industry approximately \$20 million in taxation that would have been diverted beyond regulatory need. In my Association’s view S.B. 165 is a fair deal for the regulatory agency whose professionals have demonstrated that they are seeking stable funding necessary to perform their mission.
2. The second aspect looks back on the urban drilling experience and proposes ways to better address concerns raised by local governments since HB 278 was enacted in 2004.² S.B. 165 will not overturn HB 278, nor will it corrupt the legal principles that underpin that legislation. Significant components include:
 - Create a site-specific inspection before a permit is issued to look at each well site and maximize local authority input into the permitting process.
 - Modify H.B. 278 notification requirements to simply require that the permittee notify all landowners within 500 feet of the proposed well site.
 - Within urbanized areas, increase liability insurance coverage for property and bodily injury to \$3 million – a fivefold increase from current law.³
 - Provides the DMRM with the means to implement rules on noise mitigation for drilling operations.

² H.B. 278 recognized that the State of Ohio has a statewide interest in the orderly conservation and development of the state’s crude oil and natural gas resources. Thus, H.B. 278 made clear that the Ohio Department of Natural Resources, Division of Mineral Resources Management (DMRM) has sole and exclusive authority to regulate the permitting, location and spacing of oil and gas wells within the state (O.R.C 1509.02).

³ Current law requires liability insurance for property and injury coverage each in the amount of \$300,000. Thus, the current combined requirement is \$600,000. S.B 165 requires a minimum of \$3 million of coverage to include both risks - a combined fivefold increase.

- Maintains the regulatory practice of mandatory pooling, but imposes upon those making an application a limit of five requests per year and a \$5,000 application fee per request. This change will encourage the leasing agent to accommodate the landowner without involving state authorization. The bill will also institute requirements on the well owner to avoid surface-impact protections and setbacks in order to shield pooled landowners.
3. The third theme proposes to generally update Ohio law as an Ohio response to the current issues being debated nationally regarding oil and gas development. Significant issues to be addressed include:
- Codify modern well construction and completion practices with particular attention directed to geological, reservoir containment and social considerations. This is the core issue underlying the Bainbridge Incident.
 - Requires step-by-step notification to the regulatory agency at each stage of the well drilling and completion process, including all cementing stages and prior to well stimulation events. This is a core Bainbridge issue and relates as well to other protective needs across the state.
 - Requires certain production techniques to monitor and ensure safe operating conditions.
 - Institutes significant regulatory enforcement methods to accelerate enforcement actions. These provisions would dramatically shorten enforcement time frames and provide state authorities new enforcement tools while ensuring due process.
 - Provides enhanced authority to the State to ensure that operators who own non-producing wells plug those wells in a timely manner. This is a significant national issue.

Conclusion for Legislative Need: S.B. 165 has a focus on current issues related to development of oil and natural gas resources in Ohio. The bill provides a significant upgrade of safety and health protections within oil and gas law to benefit the public interest. The public interest includes the orderly development of the state's resources. It ensures that experts remain in charge over Ohio oil and gas development by properly managing risks instead of simply banning development of Ohio's energy resources.

S.B. 165 is designed to give the Ohio public good reason to have faith and trust in the Ohio regulatory program.

Major Drivers for Legislative Need:

Well Construction Methods: In December 2007 an operator drilled a well in Bainbridge Township, Geauga County that led to natural gas escaping the well casing and infiltrating the aquifer. As a result one house was severely damaged and twenty water wells were impacted. The "Bainbridge Incident" was a serious event. Following an extensive investigation the DMRM concluded that the operator's faulty well construction practices resulted in mechanical integrity failure of the well. S.B. 165 will enact law that clearly updates well construction methods relying on modern well completion techniques while providing for regulatory verification of well construction at each stage of the process.

Spacing, Setbacks and Pooling: Spacing and setbacks are two distinctly different issues.

Spacing: Spacing regulates access to subsurface reservoirs. Ohio, like many oil and gas producing states, is a "spacing state". Ohio law is specifically designed to protect the conservation of the state's oil and natural gas resources. Since 1965, Ohio has had statutory requirements for the minimum acreage (usually 20 or 40 contiguous acres depending on depth) necessary to create a drilling unit on which a producer may drill a well to produce a specific reservoir. The well must be sited with respect to minimum distances from the unit boundary line. The drilling unit size is based on petroleum engineering standards that consider conditions necessary to realize efficient drainage of

the resource using only one borehole through a reservoir rock at certain depths and anticipated downhole pressures, applying commonly accepted porosity and permeability characteristics.

Spacing ensures orderly development and protects landowners' correlative rights pursuant to the "rule of capture".⁴ Conversely, units are designed to limit inefficient over-drilling while maximizing the recovery of the state's resources. Without spacing, economic competition would mean many wells would be drilled where only one well is needed. However, spacing encumbers property rights and thus requires protective mechanisms to insure that landowners are not denied access to their minerals. (See pooling discussion below.)

Setbacks are health and safety surface requirements authorized under O.R.C. 1509 and promulgated under the administrative code. Setbacks regulate surface activity by establishing the minimum distance a well owner must comply with when siting the surface location of a wellhead and associated production facilities from an occupied dwelling, a road, from another well, or from other facilities.

Since 1965, I am not aware of any reported incident involving the drilling of a well that occurred beyond Ohio's existing 100 foot setback regulation. Ohio's 100 foot setback is well within the norm established by many other states. In fact, it exceeds by 100 feet the standards in Texas and Oklahoma. Ohio's setback distances, as applied to the 76,898 wells that have been drilled since the regulation went into effect, have a sterling track record.

Ultimately, the setback standard impacts the landowner who has negotiated a lease agreement that conveys his best interests and has consented to have a well drilled on his property. And, it does so without unduly encumbering the landowner's property rights.

Pooling: Pooling protects landowners' correlative rights and avoids a takings. Most often a landowner owns enough contiguous acreage, of sufficient size and shape, to satisfy Ohio's legal requirements to drill a well on his property. If a landowner does not own sufficient acreage, he can "unitize" his acreage with adjoining landowners to achieve the spacing required by law. This could mean as little as two landowners or as many as several landowners joining their mineral interests together to satisfy spacing requirements to do the same thing. In other words, access to a subsurface reservoir can be "unitized" – "joined together" – to the benefit of many landowners. But, just because Ohio requires a minimum acreage standard doesn't mean that the State can deny a landowner access to his mineral rights.

Sometimes, a minority acreage landowner refuses to join a unit even though his mineral rights are small but necessary to legally form a drilling unit. This individual decision could make it impossible for the majority landowners to access their mineral rights. In that event, mineral rights legal experts maintain that it is constitutionally necessary for state government to mandatorily pool the minority acreage so that the majority owners are not denied access to their mineral rights. (See Fig. 5)

Critics of mandatory pooling claim that the practice equates to eminent domain. However, when a landowner's mineral rights are pooled the property is not seized and his property is not taken. Instead, the pooled landowner's subsurface minerals are developed (because nature and geology say it would be) and the pooled landowner receives his pro-rata share of the royalties, as well as interest income from the well not available to other royalty owners.

⁴ "Rule of Capture" is a mineral law concept that is applied throughout the United States which recognizes a property owner's right to develop the oil and gas under the owner's property.

If not for pooling, what would really happen is that the minority interest would be taking his neighbor's mineral rights by denying them the ability to achieve the necessary acreage required by law. It would be unconstitutional for the State to require spacing and not have mandatory pooling. That is why most spacing states also have pooling mechanisms.

However, leasing competition in northeast Ohio where it is common for landowners to own small tracts has generated many pooling applications. Pooling is designed to protect landowner mineral rights. It is not to be used as a competitive lease acquisition technique. S.B. 165 deals with this issue by instituting "throttles" on the practice to decrease incidents where aggressive land agents have abused this necessary development practice.

Background Discussion: Ohio mirrors the nation and typifies the push back against oil and gas development emerging from many oil and gas producing states. Anti-oil and gas advocacy organizations are attacking energy development by promoting an agenda that would corrupt long-established regulation specific to the unique nature of oil and gas development as found in landmark federal environmental laws.⁵ These statutes rely upon the rational principle that state regulation is the preferred forum to regulate this industry. That's because geology and production practices vary greatly from region to region.

There are two overarching themes that consistently come into play. 1) Whether it is in the public interest that regulatory policy appropriately manages the risks associated with oil and gas development or should these risks simply be eliminated; and 2) the validity of the long-standing principle that state-based regulation, firmly grounded in the evolution of sound regulatory policy applied by experts, is the preferred regulatory model.

Our critics would deflect Ohio regulation either to the federal level or back to the local level. Either way, they know that to do so would severely impede new development.

To reinstitute local control over oil and gas development ignores Ohio's state-wide interest in the orderly development of the state's resources; grants regulatory authority to entities who fundamentally fail to possess the resources or the expertise to adequately protect the public interest; would violate private property interests; deny citizen's access to their correlative rights; would lead to chaotic mineral resource development; and for all practical purposes eventually result in a de-facto moratorium on the development of Ohio oil and gas resources. Substitute House Bill 278 was enacted in 2004 to avoid such complications. Since then the courts have upheld the fundamental constitutional principles that supported the legislation.⁶

As is now common elsewhere, critics of the Ohio oil and gas industry are directing their attacks toward the Ohio oil and gas regulatory program (O.R.C. 1509) and the agency (ODNR/DMRM) that administrates the program. Ultimately, these critics seek to stop energy resource development by saying that the risks associated with developing Ohio energy resources outweighs the benefits citizens receive from local energy supplies.

For example, a legislative proposal promoted by the Northeast Ohio Gas Accountability Project (NEOGAP), a group affiliated with the Colorado-based Oil and Gas Accountability Project - an extreme anti-development organization, goes to considerable lengths to discredit the Ohio regulatory program as a method to halt Ohio energy development.⁷ The Colorado group has

⁵ "Drilling Down", Natural Resources Defense Council, New York City, NY, October 2007, www.nrdc.org
"Oil and Gas at Your Door?", Oil & Gas Accountability Project (Earthworks), Durango, CO, July 2005, www.ogap.org

⁶ *Kellner v. Sponsler*, Court of Common Pleas, Cuyahoga County, Ohio, June 14, 2006

⁷ www.neogap.org

converted Colorado from one of the leading oil and gas production states in the nation to a state where only 6 drilling permits per month are now being granted. Despite their disclaimers otherwise, the goals of NEOGAP and similar groups elsewhere is to stop economic activity in Ohio that generates practical and efficient energy resources.

Good public policy and, ultimately, the fate of the Ohio industry are intrinsically tied to public faith and confidence in the Ohio oil and gas regulatory program. The goal of S.B. 165 is to evaluate regulatory needs in light of these current issues related to Ohio oil and gas development, propose rational solutions, and institute upgrades to O.R.C. 1509 necessary to sustain the public's trust.

The Ohio Oil & Gas Association urges the Senate Environment and Natural Resources Committee to favorably report Senate Bill 165 to the Senate floor. I look forward to addressing your questions today or at any time while the legislation is under consideration.

Respectfully submitted:

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Tom Stewart serves as the executive vice president of the Ohio Oil and Gas Association (OOGA), having been elected to that position in September, 1991. At OOGA, Stewart is director of staff, editor of the Association's publications, serves as an industry spokesman to media outlets and other forums, and is an industry advocate as a registered legislative agent. Stewart lobbies on his members' behalf in Columbus and Washington D.C.

Stewart serves as the Ohio associate representative to the Interstate Oil and Natural Gas Compact Commission (IOGCC) (<http://www.iogcc.state.ok.us/>), having been appointed to that position by Governor George Voinovich in 1997. At IOGCC, Stewart has served as chair of the Public Outreach Committee, one of eight standing committees of the Compact.

Stewart is an active participant with the Independent Petroleum Association of America (IPAA) (www.ipaa.org) and serves on the IPAA Environment and Safety Committee, the Communications Steering Committee, the Gas Pipeline Safety Sub-Committee and is an original member of the management team organizing the national BRIEF Project. <http://www.energyindepth.org/>

In December, 2001, Stewart was elected to the Board of the **State Review of Oil and Natural Gas Environmental Regulations, Inc. (STRONGER)** as one of three representatives for the U.S. oil and gas exploration and production industry. During 2003, Stewart served as chairman of the STRONGER Board. STRONGER is a non-profit organization created to administer and advance the state review process of the States' oil and gas exploration and production waste management regulatory programs. STRONGER is stakeholder-driven process with equal representation from government, industry and the environmental community. STRONGER's objective is to foster constant improvements in state oil and gas regulatory programs in order to protect human health, safety and the environment. <http://www.strongerinc.org/>

From August 2002 to November 2005, Stewart served as the secretary treasurer of the Liaison Committee of Cooperating Oil and Gas Associations. The Liaison is a national network organization of state and regional trade associations that represent the independent oil and gas exploration and production industry in the United States. Stewart was responsible for coordinating the organization's efforts.

Prior to joining OOGA, Mr. Stewart has fifteen years of formal experience in the oil and gas industry as an oil and gas producer and provider of contract drilling services. He is the third generation of his family to engage in exploration, development and production of crude oil and natural gas.

The Ohio Oil & Gas Association is a statewide trade association with over 1,500 members who are actively involved in the exploration, development and production of crude oil and natural gas within the State of Ohio. Since 1947, the Association's mission is to protect, promote, foster and advance the common interests of those engaged in all aspects of the Ohio crude oil and natural gas exploration and production industry.

Ohio Oil & Gas Well Activity

1888 - 2008

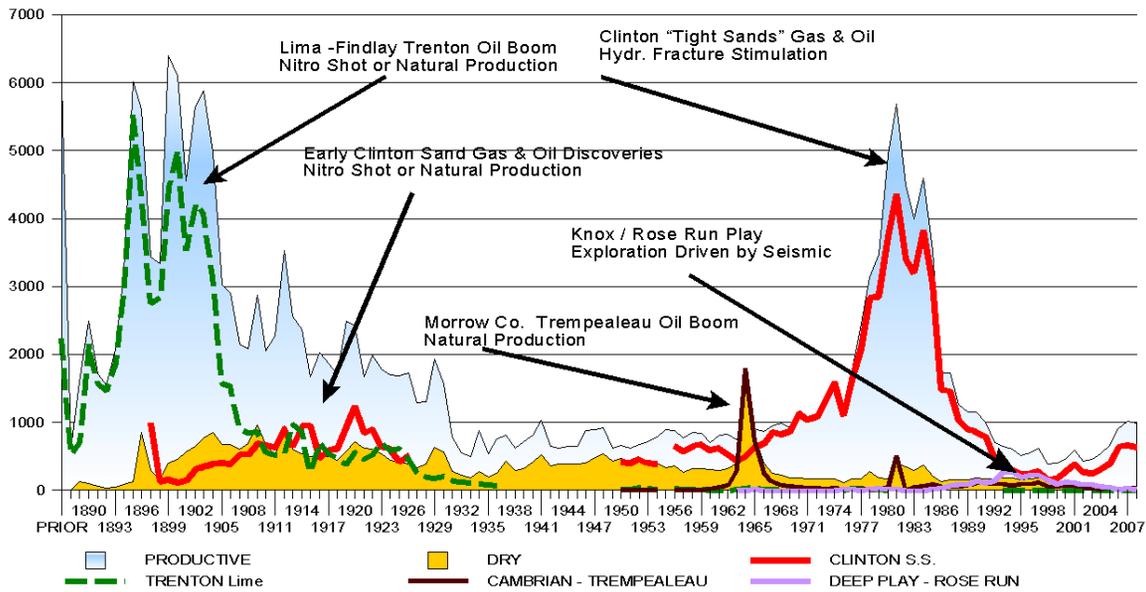


Figure 1: Ohio Drilling History

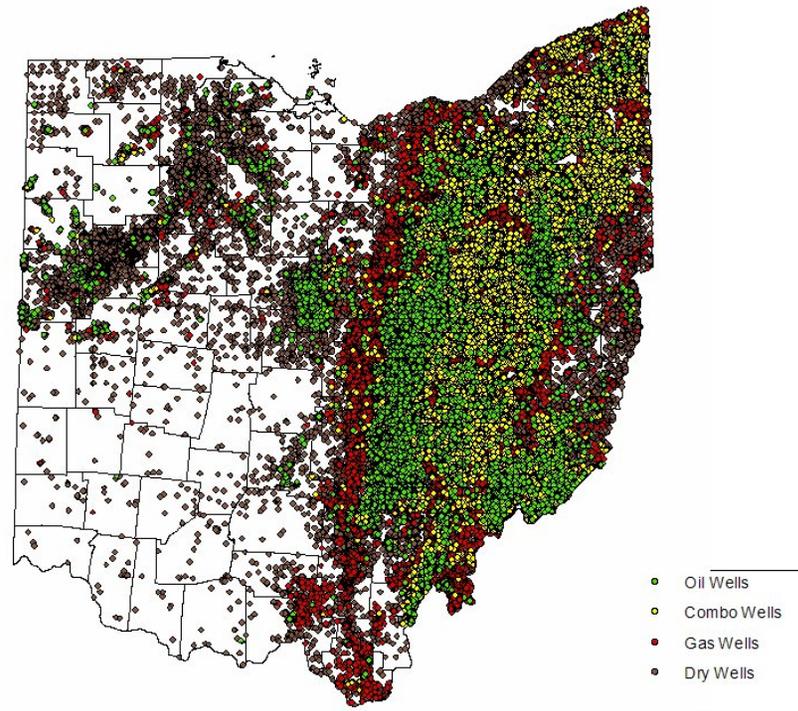


Figure 2: Ohio Well Spot Map

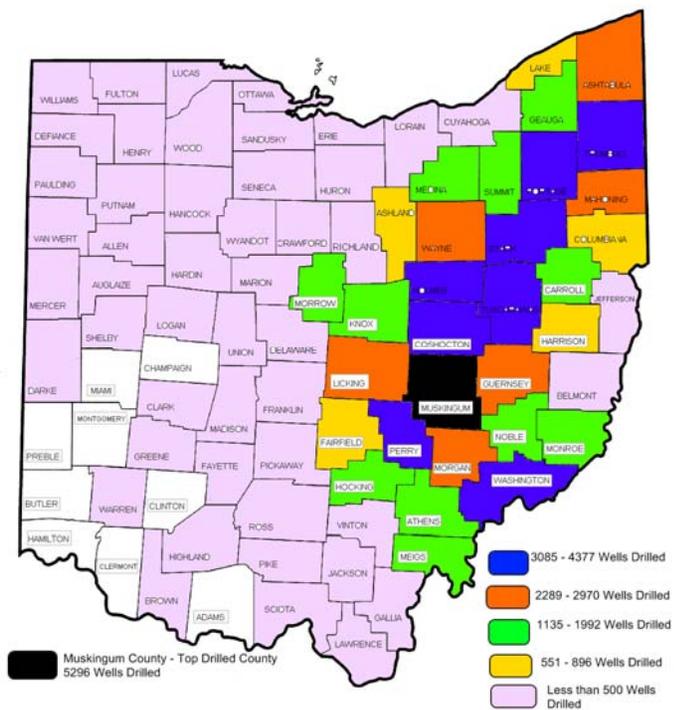


Figure 3: Wells Drilled Over 40 Years

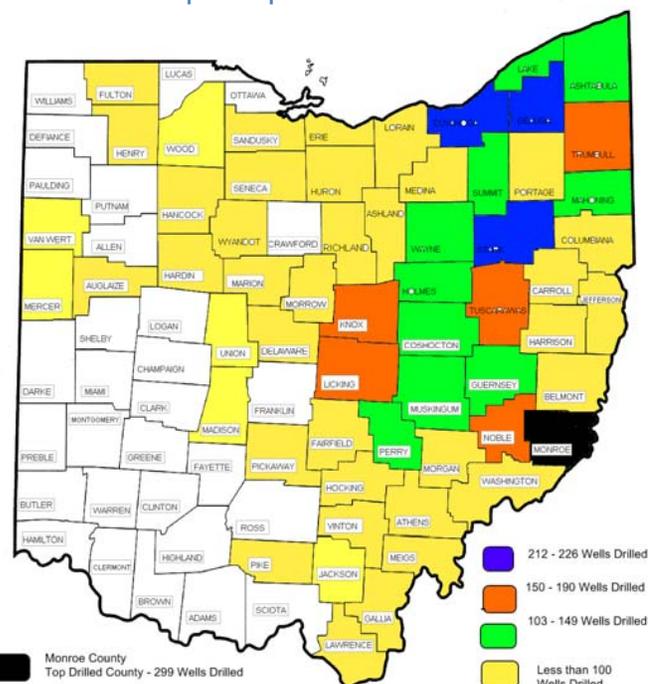
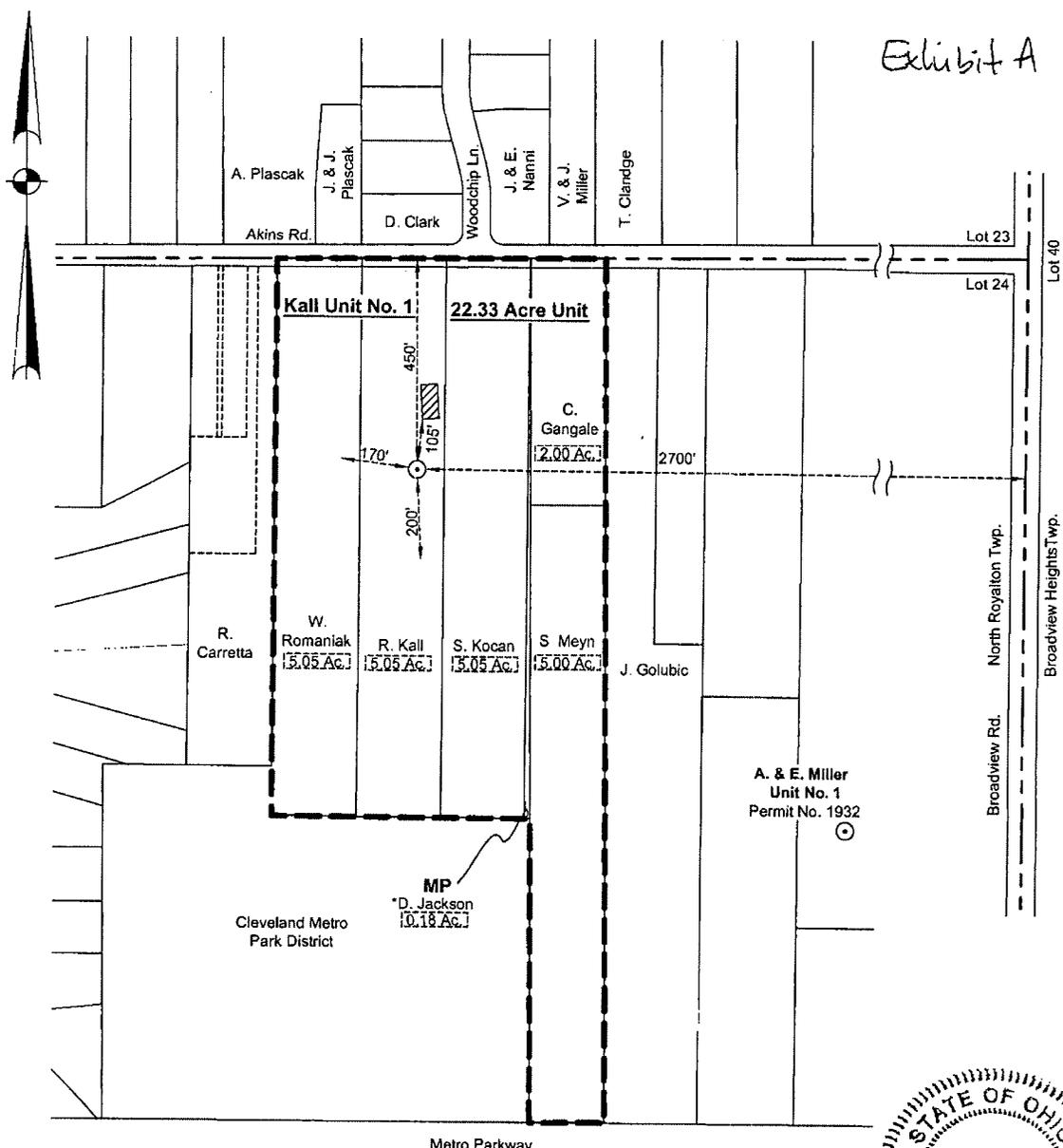
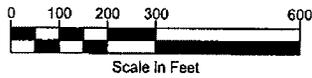


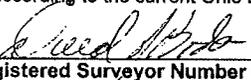
Figure 4: Wells Drilled Over Past 4 Years

Exhibit A



* Mandatory Pool Distance to Well is 240'



Plat Showing Location of Well	
State of Ohio, Department of Natural Resources -- Division of Mineral Resource Management, Columbus, Ohio	
Kall Unit No. 1	
<u>XX</u> Oil or Gas	<u>XX</u> New Location
Scale: 1" = 300'	
I hereby state that all drilling or producing wells within 600 feet and all public roads, railroads, buildings and streams within 200 feet have been shown, there are no drilling unit lines nearer than 300 feet, that this plat is true and correct and was prepared according to the current Ohio Department of Natural Resources, Division of Mineral Resource Management (OAC 1501:9-1).	
 Registered Surveyor Number 6321 or Registered Surveyor Number 8239	
David Bodo & Associates Professional Surveyors P.O. Box 396, Carrollton, Ohio, 44615 (330) 627-3639	
Operator: <u>GonzOil</u> Address: <u>5260 Fulton Dr. N.W., Canton, Ohio, 44718-1806</u> Landowner: Surface <u>R. Kall</u> Minerals <u>R. Kall</u> Well Number: <u>1</u> Drilling Unit Acre: <u>22.33</u> County: <u>Cuyahoga</u> Township: <u>North Royalton</u> Urbanized Area: <u>City of North Royalton</u> Quad: <u>Broadview Heights</u> (NAD 83) Ohio State Plane Coordinates (NAD 27) X <u>2,189,810</u> X <u>2,221,275</u> Y <u>597,990</u> Y <u>597,960</u>	Subdivision Civil Township Township: <u>5 N</u> Range: <u>13 W</u> Quarter Township: <u>--</u> Section: <u>--</u> Lot: <u>24</u> Tract: <u>--</u> Allotment: <u>--</u> Fraction: <u>--</u> Other: <u>--</u> Elevation: <u>1170'</u> Date: <u>3/30/2007</u>
<small>Coordinates are based on actual GPS field observations</small>	