MINUTES
MONTANA SENATE
51st LEGISLATURE - SECOND SPECIAL SESSION

FREE CONFERENCE COMMITTEE ON SENATE BILL 1

Call to Order: By Senator Delwyn Gage, Chairman on May 24, 1990, at 9:23 a.m. The meetings continued over the course of May 24 and May 25. The entire deliberations of the committee are reflected in this set of minutes.

ROLL CALL

Members Present: Senator Delwyn Gage, Senate Chairman, Senator Crippen, Senator Mazurek

Representative Schye, House Chairman, Representative Kadas, Representative Patterson

Members Excused: None

Members Absent: None

Staff Present: Jill Rohyans, Committee Secretary, Jeff Martin and Lee Heiman, Legislative Council Staff (Lee Heiman staffed the conference committee both May 24 and May 25 and prepared the final amendments. Jeff Martin staffed the conference committee May 24 only.)

Announcements/Discussion: These minutes reflect the ongoing deliberations of the conference committee sessions over a two day period, May 24 and 25. The minutes indicate the breaks which were taken during the two days to allow the committee members to meet with their respective caucuses. The following is a verbatim transcript of the entire committee deliberations.

Senator Gage:

I would like to call the meeting together of the free conference committee on the House amendments to Senate Bill 1 and perhaps need to ask you to note the members who are from the House Committee and the Senate Committee. And would like to first explain what I understand the amendments have done and ask the House members to comment if they have a different understanding than that.

First of all, its my understanding that there was, in statute, a provision that the first five barrels of oil production from a stripper well was not subject to state severance tax and that provision has now been stricken from statute. In addition, there was a provision that up to the next five barrels of stripper oil was subject to severance tax at a 3% rate. And that has been stricken from the bill - from statute.

With regard to gas, the first 30,000 cubic feet of gas was not subject to any state severance tax on a stripper well and up to the next 30,000 cubic feet was subject to a 1.59% state severance tax and those have been stricken from statute.

Further, there was a provision that tertiary production - the incremental portion of tertiary production - was subject to a 4.2% rate of local government severance tax and .. I've got to look and see for sure where the other rate was.... a 2.5 % state severance tax on the incremental portion of tertiary production. That has been stricken from statute.

And, in addition, there is a provision for the Revenue Oversight Committee to study the flat tax on oil, gas and coal in almost all of its aspects. There are some who understood that the changes in state severance tax were retroactive. I don't read it that way. I read that those -that only local government severance tax was retroactive.

And with those explanations, I guess I'd ask Representative Schye or whoever of his committee would like to comment on those or correct those if they would like to.

Representative Kadas:

I take responsibility that any changes in tertiary or state severance tax were an error on the part of my amendments. And I take responsibility for that. And I - the only excuse I have is that we were trying to get a bill through committee and through the House so that we could it into conference committee and get this job done. And I offer the amendment to reinstate any of those changes in state severance tax and tertiary taxes back to the way they were in - the way the bill came to the House from the Senate.

Senator Gage:

Okay, thank you Representative Kadas. I guess the question I would have - would ask you - is - with your determination that, I assume you are saying, those were made in error.

Representative Kadas:

Yes.

Senator Gage:

Are we now going to be faced, when we start talking about negotiation of where we want to be, are we going to be faced with the proposal that "Hey, we've already given you back state severance and tertiary"?

Representative Kadas:

No.

Senator Gage:

Or how does that fit into the whole negotiation process?

Representative Kadas:

Senator Gage, those were an error on our part. They were not meant to be part of the negotiating package and I don't intend to negotiate over them. I intend to give them to you because I didn't intend to take them in the first place. In much the same way that I think the additional 30,000 cubic feet on gas was mistakenly taken out in the bill last summer. I think there is an ironic similarity to the mistakes here. Fortunately, we will catch this one before we need a special session to recover from it.

Senator Gage:

Thank you, Representative Kadas. I will then ask for a motion that the House recede from those amendments that affected tertiary production and the state severance tax.

Representative Kadas:

So moved.

Senator Gage:

You have a motion before you. Any further discussion on the motion? Hearing none, I would ask the Senate members - all in favor of the motion indicate by saying aye.

Senators Gage, Crippen and Mazurek:

Aye.

Senator Gage:

House members in favor of the motion indicate by saying aye.

Representatives Schye, Kadas, and Patterson:

Aye.

Senator Gage:

The motion has passed unanimously.

Okay, the difference, then, that's left in the bill. Rates, as they went to the House, were 8.4% on regular oil, 4.2% on stripper oil, 12.5% on royalty share of oil, 15.25% on regular gas and royalty share of gas, and 7.625% on stripper gas. As the bill came back - as the amendments came from the House, there is now an 8.93% tax on all oil, including stripper and royalty share, and a 16.21% tax on all gas, including royalty and stripper share. Is that a correct understanding of everyone? And hearing no comments, where would you like to go from there?

Representative Kadas:

I think that's what we sent you and we'd be interested in knowing where you would like to go from there.

Senator Gage:

Well, if we want to shorten this real short, I'll give you a real short one. In labor relations they have, as I understand it, -- I served on the school board in Cutbank for nine years and seven of, eight of those I was on the negotiating team for the teachers and the school board. And that's not fun, folks. But, they have a procedure that they call, as I understand it, the "last best offer". And I'm going to give you my last best offer. First, I guess I need to explain to you why I understand there is some thought of going to the rates that were originally in SB 1. And I explained that to the committee yesterday, but I'll explain it to you again so you will understand why I'm proposing what I'm proposing.

We wanted to get a bill prefiled so it could go out to legislators on where we were at that time. And, at that point I wasn't sure what I wanted to do with that, but the Governor's Office and all of us thought it was a good idea to get three bills out on the three subjects of the call to every legislator. So at that point I said let's put royalty at 13%, leave the other rates the same, and that brings the bill to tax neutral '87. After those bills went out, I started working on rates and talking with industry people in my area, which is almost totally stripper, and Montana Petroleum Association people and some of their members to get some feedback on what they - where they would like to be. And the people in my area had considerable differences from what the Montana Petroleum Association people and their people that I talked to had. And, as a consequence of that, those initial conversations that I had with those people, I said, " well, I'm going to put in" - I said to me -" I'm going to put rates in an introduced bill that will put royalty holders on oil and royalty holders on gas at a tax neutral 1987 production year basis in the initial bill". "I'm also going to put rates - and then I'm going to back into - from those calculations - the rates that the working interests would have to pay in order to be tax neutral on a product neutral basis; and then I'm going to make a calculation of what the regular producer would have to pay in order to pick up a 50% reduction for the stripper people." And we have a lot of concern about whether that is justified. I personally think it's good tax policy. And, as you can well appreciate, since my area is primarily stripper, I'd be crazy to think otherwise. But regardless of that, the bill as we left it in the '89 special session, had those provisions in it. And as I worked those figures out, I came to $41.8 million, or something in that neighborhood, which was the figure that at that point I had from the Department of Revenue. And, either before that time or after, they reduced their amount to $40.4 (million), approximately. And it may have been before this, I can't tell you that, but at least I wasn't aware that they had reduced those rates. And I was told that that reduction came about for two reasons.

First, they had - there had been some net proceeds put in the wrong school district and that made a difference in - because of the millage differences. Secondly, some producer had included his new oil or gas, or both, in his net proceeds tax return for '87. And that had to be backed out of there, because it was not subject to net proceeds tax. The combination of those came to about $1.5 million. So, their figures ultimately came to $40.4 million.

When I finally talked with - When the producers in my area and the stripper producers up there who are members of what's known as the Northern Montana Oil and Gas Association got together with the Montana Petroleum Association primarily through Jerry Anderson's efforts, started talking about it -- well, let me back up a little before that even. The Montana Petroleum Association on the 10th of May had a meeting in Billings and I was not invited to that meeting though I think I could have been had I requested it. But I specifically told them I will not be at your meeting because I have the feeling that sometimes some of you folks are not willing to say exactly what you feel when I'm there. And I think you need to talk among yourselves without any legislator hearing what you are debating. Ultimately, they came up with some proposals and their first option was to go with the rates that were in SB 1 when it went to the House. We had a bit of a time talking the Northern Montana Petroleum Association people into whether they should join in that whole effort. And finally were successful in getting that done on the basis that if you come into the legislature as a split industry, you may well get nothing. And I don't know how many times any of you have heard it, but I have heard it dozens of times when people come in opposing each other in the same industry and the legislature says when you folks can work it out among yourselves, bring us back a proposal. These folks worked it out among themselves and that was the proposal that was brought to the House.

So what I'm telling you is I'm not interested in going to the original rates that were in SB1 as it was introduced because it is $1.5 million high. I didn't revise those rates because I didn't know where those differences were in production, so I didn't know whether to put it in oil, whether to put it in gas, how much to put in the royalty areas, how much to put in strippers, and generally, when I don't know what I'm doing, I do nothing. And I didn't know what I was doing in revising those rates so I did nothing and we went with the first option that the Montana Petroleum Association and the Northern Montana Oil and Gas people had agreed they felt they could both support. Consequently, those amendments were put in the bill. There's concern - and this is long-winded, folks, but I think it's necessary so that you know how we got to where we're at. As we took the bill up in Senate Taxation, it was my judgement, and others on the Republican side of Senate Taxation, that it appeared we were going to get nowhere with rates as far as the whole concept of tax neutrality. The crucial part of why we are here was the stripper exemption that was put in there in error. In addition to that, we ultimately found out, and there's no question in my mind that we haven't found all the bugs in this think yet but we came to realize that because of quirking what we did with the first year and making it based on the previous year's revenues we had dropped both net proceeds and local government tax out of the guaranteed tax base. That needed to be addressed and that was in the bill. And that needs to be addressed, whether we do anything else or not. As does the error in the strippers. We also found that, and we knew when we left here, that there were possibilities that there could be negative distributions on the formula that was in there, although we didn't envision that happening with any examples that we had worked out, although we were able to work out some that did do that. But we didn't know if it was really going to happen at that point. And thanks to some people who worked on it who are a lot better at these things than I am, they came up with a proposal and said we can solve that if we change that second distribution formula. And we talked about it, and they finally got it through my head what they were talking about, and I said I don't have a problem with that. I think you are absolutely right, it will solve the problem and we need to do that. That needs to be done in this bill.

As we have progressed OPI came in and said if you require us to put local government - the new oil and gas figures and local government severance tax figures into our calculations, we're not going to be able to get to the school districts in time the information that they need on their budgeting. Would you consider and amendment to make those portions that we can't handle effective for production after March 31, 1990. That's in the bill and that needs to be done.

From there, my last best offer are the rates that were in the bill when they came to the House from the Senate. Oh, one other thing, as we talked about those rates, and we determined that we were probably not going to get anywhere with those rates in the Senate, it was our determination that these other things that I have talked about that need to be handled, we had found no one who objected to those parts being taken care of. So we said the best for us to do is to split these rates out of this bill, get those things taken care of so that if everything blows up, we have at least taken care of those crucial things. So we split the bill, left those things in the bill, went down and got another bill that addressed just rates. Rates only. So that that area that we might not get an agreement on would not affect those things that it's crucial, I think - particularly for four counties, one of which happens to be mine - be addressed. And whether it's mine or not, wouldn't bother me at all, that needs to be addressed, whether it's my county or whether it's your county, or whether it's none of our counties that needs to be addressed. So that's my last best offer to you folks.

Senator Mazurek:

Which is what, Del?

Senator Gage:

Which is to go through the rates as they were in SB 1 when they went to the House. Which is 8.4 on regular oil, 4.2 on stripper oil, 12.5 on royalty oil, 15.25 on regular gas and royalty gas, and 7.625 on stripper gas.

Representative Kadas:

Let me start out. I want to thank you, particularly, for all the work you've done on this. I know you have spent a lot of time on this. I know you spent a lot of time on it in the regular session and have invested yourself into it quite heavily. I also want to thank the Montana Petroleum Association and the Northern Montana Petroleum Association for their work on it. But, the issue, and I appreciate that they have tried to bring themselves together and come to a resolution, but we're talking about taxation policy for the State of Montana and that policy is arrived at by the legislature and the Governor, not by the various industries that participate. They have a say in it and they are certainly part of the process but they do not have final word. It is this legislature that does.

Now, I guess I would be glad to kind of go through why the House got to the point that it did in the same way that you went through why the Senate got to where it did. And that may be helpful. I think we have a responsibility, though, to a least communicate and continue the process.

Senator Crippen:

Mr. Chairman, I would be just delighted to hear why you came forth with some of the rates that you have. I think we should listen to that and would probably find it enlightening. And I would like to hear that.

Representative Kadas:

Okay.

Representative Schye:

Yes. Go ahead Mike.

Representative Kadas:

First of all, we settled on the revenue amount of $35.9 million. The way we did that was by taking '88 production and the revenue generated from that on - for fiscal year '91 from net proceeds and said that if, okay, if we're going to treat local governments and schools the same - fiscal year '91 - that we'll generate the same amount of money with this new tax for fiscal year '91. That was $36.9 million and so from that point we're going to back rates into that amount. Then we looked at the Senate bill which had three separate rates for the two separate resources. And first of all, I think we thought that that is not good tax policy because we're - we start breaking up the various rates it becomes more confusing both for people like ourselves and for industry. What we need is a stable simple tax policy. I think the industry has asked for that. So we started looking at, okay, how can we consolidate these rates.

With regard to the royalty rate, we recognize that royalty owners will receive a tax break because of the shift from net proceeds to a flat tax. We also recognize that there are some problems and we've heard varying legal opinions on how well that will work to retroactively institute a new tax on royalty owners specifically. We're concerned about that. And we're also concerned about setting a rate for royalty owners that is higher than the rate for regular oil or gas and the possibility of some creative legal entrepreneurs to rewrite contracts in such a way that royalty owners would be given a minuscule share in the operating costs and therefore able to shift their tax from the higher rate to the lower rate. So, in simplification, a single rate does make more sense.

With regard to the stripper, particularly take note of the Legislative Fiscal Analyst's analysis (attachment #1) in the first column, 1987 net proceeds average effective tax rate, and you look on oil the average effective tax rate is 8.22% which is higher than the regular oil tax rate. That in no way justifies a new half rate for stripper oil. Regular oil, stripper oil is already, under the net proceeds system, being taxed at a higher rate than regular oil. I think when you address this point, Del, you describe going to the stripper rate as a policy decision. And I would agree, it certainly is a policy decision. At this point, we don't think in this special session, that we should be making that policy decision. That we should be adding a new incentive for stripper rates - a new incentive. That may be justified later on, but at this point we don't think so. So, we decided to fold the stripper rate in, as well, in essentially the same way that strippers are treated under net proceeds. The same rationale goes for strippers on gas. The numbers aren't quite as persuasive for the gas, but I think they are still - lean towards not having a half rate for gas on strippers. Also, I think the production technology would tend to rationalize having a single rate for gas. Let's see...want to add anything, Ted? I think that;s about where we're coming from. I may have forgotten one or two of the finer points, but.. Okay?

Senator Gage:

Thank you, Mike. Any questions from anybody of Mike? Or comments anybody would like to make?

Senator Crippen:

Well, yes, Mr. Chairman. I've got a comment, I guess. The figure of $45. - what was it?

Representative Kadas:

9.

Senator Crippen:

Now you arrived at that how?

Representative Kadas:

You take '88 production, which generates fiscal '91 revenue, of net gross proceeds taxes. That's the amount that that generated. And we said that, okay, in order to keep schools and local governments revenue neutral so they get the same amount of dollars in 1991 as they got in 1990, that we need to have rates - you know, whatever the rate configuration is - that generate that much money. Let me add one more thing. There - and Senator Gage has expressed this repeatedly - that the legislature will continue to come back and raise the rates on this declining resource. This base of resource that will continue to decline and let me say emphatically that that is not my intention. That we set the rates once in this special session, and we don't come back and raise them every year to make up for lost production. I don't think that's fair.

Senator Crippen:

Was that the same intention that you had last - special session last summer? You had the same intention then? The rates at a certain level?

Representative Kadas:

Yes, that we would set them and..

Senator Crippen:

Then this is the same rationale you used in your conference committee and in the hearings when you had the House Bill 28. You used that same rationale to come up with this $35 million figure? At that time?

Representative Kadas:

In House Bill 28?

Senator Crippen:

Yes.

Representative Kadas:

Well, we didn't have a conference committee on HB 28.

Senator Crippen:

Well, you were on the committee, that...it was your bill, wasn't it?

Representative Kadas:

It was Schye's bill. He didn't like it very well after the Senate got done with it, unfortunately.

(Laughter)

Senator Crippen:

Yeah, you guys all look alike.

(Laughter)

Representative Kadas:

I know the feeling. I know the feeling.

Senator Crippen:

I guess it was the $35.9 figure used during that time. Is that the figure available at that time?

Representative Kadas:

Yes.

Senator Crippen:

So now, you found it out now, so you're going back. You have the benefit of what it is now and you're going to retroactively plug that in. Is that it? That seems to me what you're doing.

Representative Kadas:

We have more recent information and I think we ought to use it.

Senator Crippen:

But, I guess what concerns me, then, that at the time that you were doing this, and see, some of us weren't privy to this, at the time you were doing this you didn't have that information and yet all the parties came to the table, I think, in good faith - both sides - and thought that they had reached an agreement. Now, they were sort of like that, evidently, because they didn't have all that information. But you thought you did. And now what I see you're doing, is that you're coming back and saying, "well, now wait a minute, you know, we didn't have that information there and the information that we ended up with is going to have - is not going to raise the money that we felt". And I think, probably, for the most part, some of you, felt it was honestly so, that amount. Therefore, we're going to go back and adjust it. So we're going to, essentially, change the rates that we sort of agreed upon last summer to keep as the rates down the line. Because you could have indexed them at that time, or you could have done something to hedge your bets, but that didn't happen. So what you're doing, as I see it, is that is now you're saying, "well, the mistake was made, and we've got to rectify it at the expense of the other party that was at the bargaining table, the oil industry, and then have them increase their rates". You know, and I, you know, I guess I have a hard time with that rationale.

Representative Kadas:

Are you saying that we ought not to adjust the rates at all?

Senator Crippen:

I'm just saying that I think that both parties, when they were there a year ago, obviously, one felt the rate was here and one felt it was here. I mean, they felt it was going to be revenue neutral. You bargained in good faith at that time. Now you are finding out that it didn't quite work out that way and you're saying, "gee, we need more money". Well, that's fine, you probably do. I'm not arguing that, based on what

may have happened, but you didn't have those figures there. And so what you saying to me is that you want to have the other party come back in, now, and increase their ante into this thing, into this pot, so it will bring it back up to revenue neutral as you see it. And, I, you know, because.... that $35.9 million figure had been used back there, as the basis, then you might have an argument. But as I understand it, it wasn't.

Representative Kadas:

The figure that was used then was over $40 (million).

Senator Crippen:

It was revenue neutrality was what the whole idea was.

Representative Kadas:

What I hear you arguing is that we ought not to adjust the rates at all, and I find that a little surprising because I think most people here recognize that the rates are not revenue neutral, and that they need to be adjusted. Now, we may fight over what the definition of revenue neutral is, but even the Governor, in his call, recognized that the rates need to be adjusted.

Senator Crippen:

I think the Governor wants to get this thing settled, as we all do. And I think, if nothing else, I think we're going to end up settling this thing with the basis of the error that everybody admitted that we made as far as some of the stripper gas wells are concerned - some of those. But again, I go back to my original statement that it seems to me that what you're trying to do is exactly what I said. You're saying a mistake was made and now you want to change it and you want to have the oil industry step forth and increase the rates, when it was obvious to me, from the testimony that we've had that those rates were supposed to be in place last summer. And you say, just now, that you want to...by gosh, if we keep these rates here, now, today, that we're not going to raise them again next time. Well, next time we're going to have a decline, you know. Well, where are we going to get the money? On new oil and gas production? Are we going to get it from the general fund? Where are we going to get it? If we want to keep that revenue neutral figure as you had it pegged at...

Representative Kadas:

I'll tell you where we'll get the money.

Senator Crippen:

Where?

Representative Kadas:

We'll get the money from new production and we'll get the money from the general fund. I mean, I have no doubt in my mind that we will not get as much money out of this base of revenue, this base of production, in coming years, no doubt at all, and I have no intention of raising the rates in order to make that up. And I hope that I can set your mind at ease on that point.

Senator Crippen:

Well, I appreciate that. My mind is not easily set at ease.

Representative Kadas:

Maybe to try to explain, to get a little better idea of this issue, in particular, is -- I don't really think we have set the rates in the first place. You know, we've put some numbers in there, but, I think everyone recognizes that we've put the wrong numbers in there. And we put the wrong numbers in there partially because of some of the numbers that we got from various interests involved in the process at the time.

Senator Gage:

I would agree with you, Mike. The wrong numbers were put in there based on (interrupted by some discussion on use of microphone system). I would agree with you, Mike, that the rates that were in the bill did not come to revenue neutral 1987 as we finally understood revenue neutral - as we finally understood the total net proceeds tax on '87 production. And that;s why I'm telling you the industry has already compromised to revenue neutral. They have come in and said, "we"re willing to adjust those rates and live with it". " We think the legislature should adjust those rates to guarantee that those rates will - would - have brought in the same amount of revenue in '87 had you been on local government severance tax as we paid in net proceeds tax." Those are the rates that you folks got in SB1. Those are already changed, they're revenue... and we concede exactly what you said. The rates that were there did not bring in that much revenue. And that's were I'm coming from.

Secondly, you say, "I'm willing to not come into the next session". Let me tell you what's going to happen, and I've told our committee folks and others, I realize some of you who were not here can say "we were not part of that bargain". Next session we're going to have some new folks around here and they're going to say, and I'm unopposed at this point, but I'm not sure I might not have a write-in opponent after this special session....

(Laughter)

Representative Kadas:

You and me both, Del.

Senator Gage:

That's right. Congratulations on being unopposed. But, when those folks come in, they are going to say, "I didn't make that bargain". " We need to look at this thing again because here we are looking at another $2, $3, $4, $5 million, hopefully, not more than that, shortfall. We have got to bump those rates again." Now let's forget about where we actually came to for a minute. And let's envision what happens in the legislature most of the time. And let's say we came in here in this special session and what we found out was, instead of the local government severance tax based on '89 production bringing in $32 million, roughly, approximately, Terri (Cohea) can give you a complete figure on it, but approximately $32 million, we really found it that it is going to bring in $42 million. And the oil and gas industry came in and said, "hey folks, we overshot the landing". "We want you to reduce those rates to bring us down to $40 million, which is tax neutral for 1987. Or better than that, we want to get to $35.9 (million) which we paid on 1988 production, which is closer to where we start the local government severance tax." Now, my question to you is, how far do you think they'd have got in getting a rate decrease? Honestly...I'm asking you for an honest opinion. On the basis of legislative...not to justify your position, but on your understanding of legislative history as to what the legislature has done.

Representative Kadas:

I'll give you an honest opinion. I don't think they'd have gotten very far at all. But, whether... you know, I think we're arguing over the point of what the dollar amount these rates are going to bring in the next year.

Now whether we pick our number or your number, the next legislature may very well come in here and try to change it. I've told you that...where we set it at...at least if we set it at our number, or something close to that, that I have no intention of coming back and trying to change that again. Now, I can't give you any more than that. I can't tell you what the legislature is going to do. And you can't give me any better than that either. I mean, that's the next legislature's prerogative. But I really don't think that...I think there are enough people around here who understand that if you continually raise the tax on a declining production base that you're going to drive the base out of production and, ultimately, you're not going to get any money at all. I think there are enough people who can get that. And so, I just, I hope we don't spend a lot of time arguing over this point, in particular. I mean, we can argue over what the number ought to be and how we ought to get there, but whether it's going to get changed in future sessions, I don't think it's going to get us any further down the road.

Senator Gage:

No, I agree with you 100% there. That's immaterial, except for one part of it. If we are willing to now go in and say, "no, we intended that we were going to change that", there will be those in the next session who are going to say, "well...", in addition to which, it's my contention that we made a deal in '87, but regardless of that, there are those who are then going to come in the next session and say, "you were willing to change from '87 to '88 - why aren't you willing to change from '88 to '89?". And with regard to those people who know that you can't continue to increase a tax on a declining base, that's probably true, in total, but there are also those out there who don't know where that level is, and they are going to continue to push until it's too late. Until they've driven these people out, and until that production is gone, and that whole production you're not going to get back. In that regard, I need to tell you a story.

A number of years ago, the oil and gas industry was on allowable production. There was too much production out there for the purchasers in Montana. So they said to the producers, "you can only produce x amount of barrels per lease and you can only sell x amount of barrels per lease per month, and I'm not sure, but it might have been even on an annual basis. But anyway, when you got to that point, if you had wells producing and you had sold all you could sell, you had two options. Either shut your wells down or put up more storage. Nobody knew how long this thing was going to last. So most of them said, "I can't justify more storage, so the only option I've got"...and a lot of those people went so far as to truck oil from one lease to another and kept good enough records that a royalty owner wouldn't come in and say "you're duking me out of my royalty by showing it on a lease that's got less royalty". The people that I did work for, we even kept records to show that we had taken x number of barrels from that lease and put it in storage in another lease to keep those wells going as long as we could. On one lease up there, this... a lady and her daughter owned that lease, and she kept that lease going every way we could possibly think of. She borrowed old storage from around the country. She did everything she could possibly do to keep that lease going. The two wells on that lease were producing a little over 25 barrels a day. This was back in the early '60s. We finally got to where we had to shut those wells down and they were down for about ten days

(Verbatim is interrupted at this point in order to turn the tape over. Notes indicate Senator Gage said when they tried to restart the well again, the production never got above two barrels a day. The verbatim transcript now resumes.)

Senator Gage (continuing)

Now that's what happens to those old fields when you stop the flow of that oil with no pressure down there, that oil stops and you cannot start it again with regular pressure. That's what water flooding is all about. It repressurizes those zones so you can start that oil moving again.

Now, the reason I bring that up is that there are going to be those who don't know what that level is. And once you stop those wells from producing, even, let alone plug and abandon them, a lot of those people may say, "well, I can't justify producing those wells any more because all of my operating costs are too high, including taxes". "Maybe if I just shut them in for a while, the price will escalate enough that I can justify producing them again." I tell you that story to give you a realization of the danger in just shutting those - causing those people to have to shut those wells in. Just because they're plugged and abandoned doesn't mean - they're not plugged and abandoned doesn't mean they're not going to come back into production again. And there are people who don't know what that economic limit is in taxation.

Senator Mazurek:

Mr. Chairman, I guess I'm starting to get concerned that we're talking about a little too much about what's going to happen several sessions down the road. And I think we need to focus on what the issues before us are. And I guess I see the House saying, "we understood revenue neutral to be - to raise enough money - to meet the estimated $385 million needs". "We set the rates based on estimates, the rates didn't generate the revenue that was thought to be raised, and so we need now to do that. On the other hand, I see you and the Senate essentially saying, "no, there was a lock tight agreement, we were going to set it on '87 production, and that is exactly what we are going to hold to"." We also - and I think everyone acknowledged that they were based on estimates. Coal was set at '88 production. I guess I hear the House saying if you're setting coal on '88 production, why aren't - why can't we go in and set oil on '88 production. We need to talk about the strippers and the fact that you now propose to change to royalties. And I think we have about three issues here: rates, strippers - stripper exemption, and whether there ought to be a separate rate on royalty holders. There's legal issues there. I think we need to talk about those. Future legislatures are going to do what future legislatures are going to do. I don't think we ought to try to estimate that at this point. But I thing we ought to get down to talking about how to get this thing resolved, focus on those three issues, and if we can find some middle ground, find some middle ground. And if we can't, I guess we need to know that.

Senator Gage:

Thank you, Joe.

Senator Crippen:

Mr. Chairman, I agree. I think Senator Mazurek is correct that we ought to start doing in on that basis. I guess my comments earlier, not being involved in this thing a year ago, I looked at the rates and the rates that you agreed upon are the same as what SB1 had with the exception of royalty, and with the exception of one stripper - the gas. You know, and I guess that's what I say when it seemed to me that both parties at that time were dealing in a good faith area. But, evidently, we're not clicking and we're not hitting. You know, there is a difference of opinion whether it should be 1988 or 1987, you didn't have the figures in front of you, you know. And I think everybody would agree to that - that probably there was some - there was that atmosphere there. But what I see now is I see an effort on the part of the House to rectify that by 1) - increasing this in sort of a simplistic fashion by bringing the rates up, albeit stripper or regular, for all oil and gas and leveling it off. And I would hope that at that point in time, after what Senator Gage has said, that I think what you've conceded that that probably is in error, that that ought not to be done. That if you want it, and if you left it the way that the House passed it, that the rates on stripper gas and oil would essentially drive those industries out of business.

Representative Kadas:

I have not conceded that.

Senator Crippen:

Well, if you haven't conceded it, then I think we're in a world of hurt because I think the testimony, as far as I've heard before our committee, indicates just that. That those rates are that high and that, in fact, is going to happen.

Representative Kadas:

Could I respond real briefly? I think it is important to note that Senator Gage and the oil industry came in with a bill that added a new kind of rate - royalty owners. And they did that, well, what's the different rate for royalty -14.2 or?

Senator Gage:

A new rate, Senator, but not a new tax on royalty owners.

Representative Kadas:

Okay, but different from what was passed in last session. That was done on the basis of information gathered since the last session. Now, I did the same thing, I looked at the information the LFA and other groups involved in this have brought. And the more I looked at it, what I saw was that stripper is already paying 8.22%. They are already paying a higher rate than regular. And that..and so looking at that, that tells me that we don't need to have a half rate for stripper. That they are doing just fine now. And, you know, it's exactly the same kind of logic as I think Senator Gage and oil industry has used to say that, well, royalty owners ought to be treated differently to say that....for me to say that strippers ought not to be treated differently.

Senator Crippen:

That's fine. The 8.22 may be an average and may not be an effective rate. And I guess that would vary from county to county depending on the mill levy...

Representative Kadas:

That's right.

Senator Crippen:

...on that. All I know is one of the reasons why we came in here to, I guess, change the rate was that if we went to mandatory increase, mandatory mill levy, throughout the state, that some of the oil industries in some of these areas are really going to get hit hard and they would go out of business. And it was that reason, albeit one of the reasons, that we decided that maybe the way to go around that is to have a flat rate. And I guess that is what everybody agreed upon in your committee and in your bill last summer. I guess I keep going back to that because I want to know where you... where everybody was at that point in time. Because I'm convinced that we're not going to resolve this thing, particularly, because I think both parties are convinced in their own mind that they were right here

and that they were right over here and what their definition of revenue neutrality is and what yours is is fine and that's where were going. And I think that SB1 as it was passed by the Senate indicated some type of a compromise on that as far as the oil industry is concerned. That was rejected by the House.

Representative Kadas:

It was not rejected by the House. It was changed by the House. You know, we changed some of the rates, we changed the dollar amount, and we did that under the assumption that we would end up in a conference committee. We anticipated that the Senate would reject that and that we would come to the conference committee to negotiate, and hopefully, that we would discuss the issues and come to some kind of middle ground. Now, if the Senate wants to take the position that there is no middle ground, then that's a little different.

Senator Crippen:

Well, Representative Kadas, I guess maybe, then, in that case, in SB1 we should have reduced the rates even further, using that logic, and then come into this conference committee so that we would have some bargaining to come back up. You know, you know...I just..I have a difficulty with that type of an approach to try to solve this problem. And...

Representative Kadas:

Well, do you think that the House position has any legitimacy at all?

Senator Crippen:

No....no.

Senator Gage:

Would you like a vote on that?

Representative Kadas:

Yeah, we..we took a vote on it....

Senator Crippen:

Yeah, if I said "not a great deal" you would... you know, that would be an insult to the House....

Senator Gage:

We did in the Senate also and it was 36 - 14 - no...

Representative Kadas:

No, I would disagree, Senator Gage. The vote in the Senate was to send it to a conference committee to discuss these issues.

Senator Gage:

But that was to say that there's no legitimacy in what you propose at that point. You know, you're saying we took a vote that it was legitimate. I'm saying that we took a vote that it wasn't.

Senator Crippen:

Well, I would say, Representative, probably in your mind, it could very well have been legitimate.

Representative Kadas:

Thank you.

Senator Crippen:

That doesn't mean that it was.

(Laughter)

Representative Kadas:

Sounds like one of our arguments on fairness.

Senator Gage:

Same thing.

Senator Crippen:

You know, I..

Representative Kadas:

Let's get back on track here.

Senator Gage:

Ted? Oh, I'm sorry...

Senator Crippen:

Oh no, I...

Representative Schye:

Well, I guess I have a question. If the oil industry and the Senate Republicans made the compromise, they left half the legislature out. They left the House out. That's what you are saying. Is that my understanding?

Senator Gage:

What I'm saying to you is when we came down here, all the talk was about we're at a shortfall on rates based on '87. And everybody that I talked to before we got here said let's adjust those rates so that we're tax neutral to '87. And that may well be. I don't know how much House involvement there was. There were meetings all over the state, Representative Schye, and I don't know how many you folks took advantage of those meetings. But, I went to the Shelby meeting, and I had a conflict so I couldn't go to the Glendive meeting. We had meetings there. Since then, the Department of Revenue and the Montana Petroleum Association have had five or six or seven meetings around the state and they got very little comment from anyone, and, specifically, they made their rounds to talk with legislators. And they got very little response from legislators on this whole thing. I don't think anybody was left out. We made as many efforts as we possibly could to give the legislators a chance to give us input on this thing, and got nothing.

Representative Schye:

I'm talking about the legislature..we're talking legislative process, now. The legislative process when the special session started. The Senate and the oil, the Senate Republicans and the oil company have set down, in your words, have compromised on this bill. The Democrats or the House together, have decided maybe that compromise wasn't a fair compromise. We want to compromise with our taxpayers at home, with our farmers and ranchers, and the small business people at home whose taxes will go up, not down in a lot of areas, because of the education bill. Now we've talked about the education bill being my bill. It was. I tried many times to separate this tax part out of that bill.

It was not allowed to be separated out at that time because you knew that the debate would probably bog down and it would not pass. So it was put into that bill. We did, we did, have to concede to that. I mean there is no..no arguments and I don't think you can argue that. But that's the way it happened in the special session and when we talk this, we are here from the House, in complete fairness, to negotiate the issues we think are on the table, to our constituents at home, the taxpayers. And right now I'm getting from you that the Senate Republicans and the oil companies aren't willing to negotiate.

Senator Gage:

Just clear the record for you on how that got into that bill, Representative. That was a separate bill, as you well know, in the Senate. And I tried to get that bill through as a separate bill so that that would have nothing, whatsoever, to do with the education bill. I was told, by a lot of people, "all you're trying to do is run something through to get a benefit for the oil and gas industry that may not get through if you put it in as a part of an education measure, and you want to make sure that you get that benefit whether we solve the school problem or not". And I didn't have the horses to get that bill through or it would have gone through as a separate bill, and in retrospect, everyone I've talked to said, "what in the world did you leave that in Education for?". And, in fact, the minutes will show, if they are that complete, that Senator Regan said, "Why in the world is this bill in Education? It should be up in Taxation.".

Senator Crippen:

Amen.

Representative Schye:

I agreed with that and we tried to change that many times and were blocked many times to change that. That it shouldn't have been in that bill. It would not, probably, have passed and we would not, probably, be here right now, if it wasn't, hadn't been put in that education bill. And I didn't vote for the education bill when it came out. This is one of the reasons.

Senator Crippen:

I didn't either.

Representative Schye:

This was one of the reasons. Bruce didn't vote for it either, but this probably wasn't one of the reasons why. But again, my question is...is the Senate Republicans willing to compromise or sit down and negotiate, or is it either we take what you have, or that's it?

Senator Crippen:

Well, Representative Schye, I guess the question that I would have to answer..ask you, first, is when you came up with these two rates, essentially two rates, 8.93, 16.21, on a particular segment of the taxpaying society, did you spend any time with them in negotiations in conference committees or what have you, with them to get their input as to these particular rates? And work with them to see their opinions as to the fairness and the propriety and so forth of these rates, or was this done some other magical way?

Representative Schye:

I guess...I guess..I mean, if you're asking me if the petroleum industry invite me to any of their meetings? No, they did not that I can remember.

Senator Crippen:

Did you invite them to any of your meetings?

Representative Schye:

When we talked...when we talked this...no...public hearings in the House and the Senate. And we listened. And I'm willing to negotiate, I'm willing to work on those. I'm willing to work on the rates. I'm willing to work on some things that are in there. But what we're hearing is you are not.

Senator Crippen:

No, you're not hearing correctly then.

Representative Schye:

Okay, are you...let me ask this. Are you different than what Senator Gage said?

Senator Crippen:

Do you want to rephrase that question, Senator?

(Laughter)

Representative Schye:

Senator Gage made the statement that his last best offer was the rates that the Senate sent over. He's saying you take what we give you or nothing. Are you making that same stand?

Senator Crippen:

I'm glad you clarified yourself. I guess what I'm saying is that I think that the oil industry, in fact, did negotiate in good faith way back...I'm talking way back in 1989, in the summer of '89...and I think as did the education group and probably others in there. I think what has happened is that that everybody thought..one thought it was 1987 and that was going to be the tax year. Keep in mind I'm arguing from the fact from a little bit of lack of knowledge because I wasn't in your meetings, not being on the Education Committee. But from the hearings, from what I've heard, is that they felt it was 1987 and that's when revenue neutrality would be pegged and that's where these rates came from. And the other side, and I hate to use the other side, that phraseology, but we'll use it, felt, no, that they used those figures, but they had something else in mind. Because the problem, I think, could have been resolved if you had used some type of an indexing formula, or something in there, and if you had pegged a particular amount of money that you were looking at. But you didn't do that. That wasn't done. So now where we are is we're right here and we have a shortfall. And, you know, I don;t know if anybody is denying that we have a shortfall, but it seems to me like we do have one. But what I see that you're trying to do is say, "okay guys, now we're going to go back to the bargaining table, but we want you to raise the ante over there because it's not what we thought it was going to be". And I guess I don't that's good faith bargaining. You know, I just don't think that's the it's done. From that standpoint, according to what Senator Gage has said, that, in fact, the oil industry has done some of that and they're willing enough to come back and change some of these rates, and evidently increase it from where it would

have been under the net proceeds in 1987. But, nonetheless, we're there and maybe we should be focusing on maybe another approach and how we are going to get this money, if, in fact, we want to get the money. Maybe we should be looking at another approach.

Representative Kadas:

We're open to suggestions.

Senator Crippen:

Are you really? Then I will have to take this little bit of...this opportunity to make a little statement.

Representative Kadas:

Please.

Senator Crippen:

We've gone through this all the years that I've been up here. And I'm sure for a long time. And we're going to have this problem more and more. It's going to get worse because we're talking about declining tax base. And we all know that. And if things don't improve, it's going to get worse even with, perhaps, with new and interim production. We're talking about a base over here that we've relied on and we've relied on and we've relied on. And we all recognize the fact that we can't rely on that as much any more. And we've had opportunities to use another source of funds, but we're not willing to bite that bullet. And I guess I'm going to have to take this opportunity, because all the cameras are rolling and all those people are sitting over there, and if you want to talk about good faith, Representative, then I would certainly hope that in the next session, that you put your money where your mouth is. And then when we talk about a sales tax as another form of revenue that we can come in and use to help fund this declining, this area where a declining tax base is not doing the job in education and other areas, that you will look on it in a little more favorable non-political manner than has been done in the past by your body. You know. And I guess I just had to take this opportunity to tell you and the public and the people there that that's where we're at and this is exactly what we've come to. And we're going to come to it in other areas if we don't get our stuff together and realize that we've got to have a comprehensive tax overhaul of our tax policy and start looking at new approaches to this thing, because we cannot continue to wring one goose, or that goose, because the golden eggs are gone. Or they've become pullet eggs. We've got to look at new sources. So I'm sure glad we've had this opportunity to discuss that and I appreciate you taking the time and listening. I look forward to seeing you next January.

Representative Kadas:

I wondered why you were on the conference committee.

Senator Mazurek:

Mr. Chairman.

Senator Gage:

Joe.

Senator Mazurek:

Let me try and get us back on the issues here. I think I have sensed, in talking with House members, that there is a specific concern about the transfer or the increase of rates to the royalty owners. There is a concern about the...you may risk losing that because of the retroactivity and legal arguments that may result in the loss of that money. But the other concern that I've heard, and I'd like to have to address that, is that you're taking - you're shifting - the burden from produces to royalty holders who, in large part, are farmers, ranchers, individuals and they are now being asked to bear this burden in lieu of the industry. And I think that's...I've heard, not just from the Democratic side, but from the Republican side in the House as well, that there is a serious concern and that's one of the reasons for that change. And I think that given the potential legal challenge on that issue and who the burden is being shifted to that that's another reason for... that causes the rates to go up. How do you respond to that?

Senator Gage:

We...one of the reasons the bill was originally drafted as it was was that...that concern about taxing different properties at different values...different rates. And, in effect, that's what has happened with net proceeds tax anyway. When you take a look at net proceeds tax. And after we got to looking at it and came to the conclusion that the feds have done that for years with windfall profit tax and probably in other areas, if the feds can do it and not get challenged, I certainly think the states ought to be able to do it and not get challenged. Nobody, to my knowledge, challenged that part of windfall profit tax. Now, let's take a look at royalty owners, Senator. There are areas in Montana where royalty owners, I had one instance of a royalty owner paying 63% tax on his royalty in Montana. Do you think he's going to to squawk about going down to 12.5 and 15.25? Under net proceeds tax. We have royalty owners in Hill County. I'm not sure what the royalty owners were paying, but it's got to be more than 22% because the working interest on gas was paying 22% and they had some deductions to take off. The royalty owners must have been in excess of 25-28%, somewhere in that neighborhood - that's a "guesstimate". So I wouldn't want to be held to that, but I can find that out for you. The people, the royalty owners, who are getting a bump are the same working interests that are - owners that are getting a bump from the same area. And that is in the eastern part of the state of Montana because there has been so much production and so much value over there that those areas that hold their millages down to the point that those royalty owners weren't where everybody else was in other areas of the state where they didn't have those huge tax bases. So, basically, the royalty owners of the state of Montana, if you eliminate those eastern folks, are getting a break even at these rates over what they were paying under net proceeds tax. The other thing you need to realize is - don't lose sight of the fact that these are statewide averages. On any individual producer these are horrendous. Let's take the guy who was out there who had no net proceeds tax at all to pay on his production. The royalty owner has always paid tax on his. 100%. If he is in a 150 mill area, he's paid a 15% tax. If he's in a 300 mill area, he's paid a 30% tax. If he's in a 450 mill area, he's paid a 45% tax. That's a pretty steep kind of a tax on a royalty owner. Maybe justified because he hasn't got any costs other than if he had to buy those royalty interests originally.

But let's take the guy out there who had that production with no cost at all. With so much cost that he had no tax at all. And I'm in a little dutch with

my stripper producers up in my country, I need to tell you that, because many of those folks are in that position. And they are subsidizing production and they are doing their own pumping and they are doing all kinds of things. And the reason I....to keep those wells in production, hoping that, ultimately, either a new method will come up or price will escalate or something will allow them to make a profit on those wells. And those folks, now, are faced with paying net proceeds tax...or paying local government severance tax. There was something in the neighborhood of 55 million in total production, oil and gas, including royalty, that there was no net proceeds tax at all paid on, not including - yeah, including royalty. The royalty owners paid tax on their share of that. But the working interest share of that 55 million because their costs were so high, they didn't have any taxable income. Those people are now going to pick up about a $4.3 million share of the taxes of the state of Montana that they didn't pay before. And some of those people are screaming mad at me and justifiably so. But I've tried to convince those people that, regardless of that, if you continue to operate those wells at a loss, it doesn't make sense. It makes no sense at all, except that you're doing it for a tax write-off, perhaps. That doesn't make a lot of sense anymore because the federal rates dropped down to the point where that doesn't make real good sense. But if they're doing that, just for the tax write-off, and I really soul-searched with that whole thing for a long time before I decided to do this, and finally came to justify it in my mind to where I didn't have any problem with it on the basis that if you're producing your wells at a loss for a tax write-off, we're going to help you out, fella. We're going to give you a little more cost on your well so you get a little more tax write-off and you can start paying some tax. If they are doing it just to keep those wells in production and hoping that the price escalates, I've really injured those people and their efforts and I'm sorry for that. But for the overall good of the industry in the state of Montana, it was my judgment that this is the best way to go. I think its the best for conservation of oil and gas resources and I think its best for tax policy of the state of Montana and I think that local government and the schools will get more money, ultimately, from a flat tax, than they will get from a net proceeds tax. Even though they can continue to escalate their mills on net proceeds. A net proceeds tax, in my judgment, will drive those wells out of production and plug and abandon status a lot faster than a flat tax will. And that's my opinion and it might not be worth a crap, but it's mine.

Senator Mazurek:

Well, anyway, the rate of royalties is going up from where it was and maybe the House wants to respond to that, too, because I think that is a fairly strong ... strongly held view in the House, is my impression.

Senator Gage:

I don't think there is any question about that, Joe. I think what the House didn't look at is the fact that where were those royalties before we got here. I don't think that entered into....

Senator Mazurek:

You mean before we got here in '87 ..or '89. We put the flat tax in in '89.

Senator Gage:

Yes, and I doubt that that entered into a half a dozen heads over there. Where were we before the flat tax went in with regard to royalties in the state of Montana?

Representative Kadas:

First of all, make just one point. Your logic is good with regard to where they were before the flat tax came into effect. That's the same logic I'm using to talk about strippers. So just keep that back there in the back of your mind, but...statewide averages, the whole thing...it's the same logic exactly.
Let's talk about royalty owners. Just talk about that and try to give you some sense of what our problems are there. First of all, the retroactivity of segregating a new group of taxpayers. Now, our own Council has told us that that creates a problem. Now that would just be a problem if that were....if we did that in the bill and we had a severability clause then we would lose two years worth of revenue. Or, I'm not even sure of that....we would lose a chunk of revenue if we lost that. That's one concern. And I guess I would like to get some response on that ....on the constitutional question and maybe ways of dealing with that.

Another problem is the ability....by setting two different tax rates, the ability of a royalty owner to legally define himself as an operator and, therefore, get the lesser tax rate. And so while you've increased the royalty rate in order to generate revenue, contracts are changed and so you're not generating it over the long term. And so you could address at least those two problems.

Senator Gage:

Yes, I'd be glad to, Mike.

The constitutionality of the different rate folks and the retroactivity of that thing....I addressed the one when I said the feds have segregated people into different brackets with windfall profit tax years ago.

Representative Kadas:

Over the long term.

Senator Gage:

So, no problem with it.

Representative Kadas:

If we did it now and made it applicable to a future date, then there isn't a constitutional problem, I agree with you. I'm concerned...the constitutional problem is about the retroactive....

Senator Gage:

Yes, I'll address that. I suppose, if you ask I don't know how many lawyers, but probably you'd get different reactions from many of them. One staff member says yeah, they think it could be a problem. Sure it could, no question about it. It could be challenged and may well be challenged. I wouldn't...I'd be the last to deny that. But, we looked into that aspect of it, as well, and found, at least in the opinion of one person, and, I think we could find dozens of others who would agree with him, that that...and I would guess that all lawyers would agree that that can be challenged. I suppose every legislator would agree that that can be challenged. I certainly could. But in the opinion that I was given, I was given to understand that if that were challenged the state of Montana would win that challenge. And from the court cases....from the information that I was given from court cases that were cited I happen to believe that the state would win that challenge. I don't know how long it would take or how much it would tie things up. I haven't any idea about that. I guess it would depend on how busy the courts were, how much appeals there would be, or what have you. But, I think the odds are in favor of the state of Montana in that instance. Personally, that's my judgement, based on the information I was given and I'm willing to go on that basis, myself.

Representative Kadas:

Okay, how about the second point?

Senator Gage:

The second one was....?

Representative Kadas:

Rewriting lease contracts.

Senator Gage:

Oh, rewriting contracts. Okay. If you talk with a...with an operator out there, and you need to know that many of these people who are in the oil and gas business are also royalty owners, have a considerable amount of royalty. And I talked about that whole thing with the Department of Revenue at some length. And the likelihood of that happening is pretty remote. Particularly with old contracts, because of the fact that there isn't that much involved with most of the royalty owners. Now I say that and I've got to tell you another story to illustrate what I'm talking about. There are very few instances where the total royalty is till owned by a person or a corporation, other than, maybe, Meridian. From my experience, at least, and I've seen a lot of royalty schedules and if you want to check that out, go over to the Department of Revenue and ask them to pull some of their royalty schedules and see how many royalty holders there are on those schedules. We have leases that I've taken care of royalty schedules on that have 50 and 60 and 70 royalty owners, some of them down to the 1000ths of a percent ownership and are getting as little as 12 and 14 cents a year. And that's a goodly share of those people, though it's a small amount of the revenue. First of all, it's not worth the time and effort for the folks to say, "well, I can save a cent or two cents in tax if I go in and negotiate this thing". Even the guy who is getting $500 in royalty a year hasn't got much to save by taking all the time and effort to renegotiate with that operator to pay a dollar a barrel so that he can save $36, maybe or something in that area, (I can't work the figures out in my head right now), but to save a small amount. The huge guy that's got huge royalties possibly would try that. I wouldn't deny that. He may make that attempt. We finally decided, in talking with the Department of Revenue in this whole thing, maybe the best way to handle it, knowing that is a possibility, is to have the Department that handles that keep track of what's happening in that regard. And if it starts happening, to then come in to the next session of the legislature and poke some language into statute that will stop that. Now, I have problems putting some of that language in right now because, first of all, if it ain't broke, don't fix it. It ain't broke now.

Secondly, this thing may backfire a different direction, someway or another, and we may start tying the hands of people who may want to start doing some things. Now let's say we've got a royalty owner out there who does have a 12.5% interest in a lease. And it is a super lease in eastern Montana. And all of his property is not leased, he still has a chunk next to a super well, and he says, "I don't have the cash right now". "I'd really like to drill an offset for that sucker, because I think I could operate that well myself and get 100% of that oil and not have to pay 87.5% to an operator if I drill that well myself and I happen to hit it - I'm set for life. So I'm going to go out and I'm going to sell part of my 12.5% on that producing property to raise the cash to drill that well." Hasn't anything to do with converting it to a working interest. He loses the royalty, but under this scenario we're saying to the guy that buys that, "you can't take that as working interest". It was royalty interest before and it's got to stay royalty interest and he may not be able to sell that on that basis. They guy who might buy it, the operator, for instance, who might buy it, and he might figure into his calculation, "if I buy that and put it into my working interest, I can save about 4% on my local government severance tax, so I've got to figure that into my sale...my purchase price of that thing". "Maybe I can pay a little more because I can cut my taxes down if I do." That guy can then maybe sell that to that fellow for a little more money to raise the money for him to drill that hole that, probably, he would not drill otherwise. Now, that may be a farfetched case, but when we put things in statute that tie it for no reason at all, nothing out there even happening, but we preclude some of that kind of stuff from happening when we do those things in statute. And we can't envision... you can't even imagine the kind of deals that are made out there for raising revenue to drill oil and gas wells. And you start tying those folks hands out there, that's part of why we got problems bringing people into Montana. We've got so much regulation out there on what people can and can't do, that people have just said, "goodbye, Montana, I've had a belly full of you folks, and I'm gone". I hope that answered your question.

Representative Kadas:

It's a start, you know.

At this point, a new tape was begun. The testimony resumes with Senator Crippen speaking.

Senator Crippen:

....and then he has a right to back in and end up with a 50% working interest. And often times that's a clause in the contract. I've been party to them before where in a speculative well, the promoter will say, "I'll keep a royalty interest of 1% or 2% overriding royalty interest, but after the well has paid off 200% to the then working owner, then I have the right to back in at 25%, 30%, 50%", however tough the deal is. And that, sometimes, is fairly common in small one well deals that aren't ranked wildcats. And you ought not to stop that. But you have to keep in mind, and I think that Senator Gage pointed this thing out, too, that anybody that is knowledgeable in this business and has got a royalty interest realizes that he or she decides that they want to become a working owner, working it, that all the liability goes with that. I can tell you, Representative, from personal experience, that that can be substantial. Because if you have problems with your well, environmental problems, for instance, or if you decide to frac the well, or do some other things like that, you're stuck. And you've got to cough it up. Ofttimes, you wish you'd kept your little royalty interest that you had and not been a working interest owner. But I guess the main thing is that you have to be careful how you structure it in such a manner that you don't impede the free enterprise system from working and people negotiating. I think, rather, you ought to be looking at the standpoint of anything we can do to get people to drill and to get new oil and increase our declining tax base, we ought to do it.

Representative Kadas:

Believe me, I'm trying to be careful. I just don't want to set up a circumstance where it's advantageous to change a couple of words in a contract and go to a lower rate.

Senator Crippen:

Well, it might be to the state's advantage for it to be advantageous at times. That's what I'm just saying, because there are times when it should be that way. And that is legitimate. And I think you do that in your...I think everybody in this room does that to some extent in certain ways to minimize taxes. Or to do something like that to preserve capital, if you have any capital left.

Representative Kadas:

We call those "loopholes".

Senator Crippen:

No, you don't call those "loopholes", Representative. You don't call those loopholes at all. I disagree with that phrase.

Senator Gage:

I might mention one other thing, Mike. There's a lot of things to consider when you start converting those interests. I think, I guess I'll give you an opinion and you can ask Joe or any other lawyer if they've run into it, but it would be my opinion that a royalty owner on a well has far less liability possibilities than a working interest owner has. Now you take, as

Senator Crippen has said, you go in there and you frac a well, or you go in there and, as a..part of the working interest owner and you contaminate somebody else's water well, or you have a big spill like the Valdez thing had on land in your area. As a working interest owner, there's no question in my mind, you're a stuck sucker. As a royalty interest owner, you might be included in the case, but I don't think they would have nearly as good a case against you as if you were a working interest owner. Lot of things you have to consider in that whole area of converting and getting into that working interest owner status. I would not do it for a few bucks difference in tax, personally, but there are some who live pretty dangerous out there and maybe would.

Senator Crippen:

Well, where are we?

Representative Kadas:

We're getting closer to lunchtime.

Representative Patterson:

Senator?

Senator Gage:

Would you like to take a break, by the way?

Senator Crippen:

No, let's go on.

Representative Patterson:

It appears like where we're at right now is we're $4.2 million off. House Democrats ran this bill through the Committee, put the amendments on, House Republicans voted against it, we had the (unclear) on the two rates, we haven't got a real (unclear) for why we have two different rates for the...what we were talking about, we haven't got that resolved yet. We're $4.2 million difference between the way came over from the Senate and the way the House sent it back. I have not heard any discussions on how we're going to narrow that gap or go with what we've got. We're wasting time.

Representative Kadas:

We already have heard those solutions. That there is no negotiation. We have the last best offer.

Representative Patterson:

Then we go back to the original question. We never heard a decent answer yet today - how those rates were picked by you, Mike, that you put in there. They were not (unclear) yesterday, the royalty owners didn't come in and say, "hey, raise our rates". They didn't complain. They didn't protest the bill. The bottom line is we come in here, we say we need $35.9 million, no matter what the production was, we'll come up with some sort of figures, and say these numbers will generate that kind of money. That is what it appears to me is what we've done here in the House.

Representative Kadas:

That's right.

Representative Patterson:

We said we don't care what the rate is, we need #35.9 million. So we just came in here and we plugged in some rates and say that will generate that kind of money. I don't think that is what we want to do for taxation policy on oil and gas.

Representative Kadas:

Okay, you tell me what you think the rates ought to be or how you ought to find out what they ought to be.

Representative Patterson:

As you said before, we're going to do a study on this bill. Revenue Oversight Committee is going to look into it if this bill were to pass. If not, we can always go to the fall back position as where it is now.

Representative Kadas:

That doesn't sound like progress to me.

Representative Patterson:

It's not progress. I agree. You look at Senator Gage's bill. He did increase the rates. He was generating more money than what we're bringing in today. We go out here and have no bill at all - we're doing a disservice to the state of Montana and to the oil industry. We take Senator Gage's bill, we're generating some additional income. Not as much as, maybe, the House Democrats would like, but still be a track to the right direction. I agree, we cannot bind this session of the legislature to what the next session going to do. We know that these deals are only good for while we're here today and we cannot bind the next session to what the rates are going to be. And I know as well as you do, rates are always changing up here. They never stay the same.

Senator Gage:

I guess to comment, they asked you how your rates were set, Mike, and you response was, "where do you think they ought to be?". And I've given you that. At least what I've given you is based on something other than 1988 net proceeds tax. Mine, at least, say....the oil and industry have said, "we're willing to pick up part of the....those of us who are big operators and have more than marginal stripper wells, are willing to pick up the bigger part of the tax revenue the state is getting in order that those littler - smaller, marginal producers can stay in business longer". "So we'll pick that share up. And we're willing to set those rates so that, ultimately, we determine that they don't bring as much as we paid in tax in 1987 in net proceeds tax. We're willing to increase those rates to do that." "No question," they said, "we're going to lay that burden on the royalty owners". Some of which are them - are themselves. But at least they are based on something. And they were willing to come in here and live up to the deal that was made in the 1987 session. Had we wanted to say to those folks, "we want $40.4 million from you folks" or "we want an assurance that we're going to get $35 million" or $20 million or whatever, we could have put in that bill that information and said rates will be adjusted every year based on gross production to bring in x number of dollars. We didn't do that. Now we're coming in here and telling everybody how smart we were because we've got hindsight to say we want $35.9 million as a starting place. And as I indicated to you earlier, had that been $45 million, there's no question in my mind that we would not have been in here saying we want rates at $35.9 million as a starting place.

Senator Mazurek:

I guess I'd respond a little bit to that because I think you're focusing on the very issue. And I think we've heard it in the committee - I don't think anybody talked about $35.9 million in 19--at the special session a year ago. But they talked about, based on estimates, it's going to take $385 million to fund HB 28. Based on the '87 production information we have, we think it will take rates to generate the net and gross or the net proceeds portion of that has to have, based on estimates, a certain percentage of that. And I think what we're finding out now is that, at least from some people's side, that these rates don't generate the revenue to fill that gap. And there is recognition on industry's part because they're coming in here saying they're willing to get...the question is, where do we get to? So I don't, I mean, I don't think it's quite as simple as there's no basis for any of this discussion. There is. I think there...we have heard honest differences from both sides as to what we were trying to do in 1989 special session. And I think what we need to focus on is are we going to meet....are we going to accept those two points of where we were supposed to get and try and find some middle ground between them, or are we going to take a hard line on each side and do nothing. So, we're finally getting to the point where we need to make a decision as to whether anybody is going to give.

Senator Crippen:

I guess, Senator Mazurek, the question to ask you then ...in your figures of 300 and whatever thousand, million, dollars it was in HB 28...you also had other sources of revenue coming in besides just this revenue here. And you made that on estimates. Good faith estimates. Suppose that some of that revenue from other sources did not come in as you saw - that you had hoped that would come in - and was short. Would you then go back to that tax paying entity and say, "now, wait a minute, we figured we were going to get so much and we didn't get it, therefore, we're going to have to get more from you to bring it up to what we estimated that we would have to have that we budgeted for"?

Senator Mazurek:

Well, on those other...we don't have the lag time like you have in this industry. For example, coal used '88. We didn't even have production figures and that's why we used '87, that's why we estimated. And I don't recall that we set up a whole new taxation system for any other industry. And this was a shot in the dark with a whole new system. A complete change in how we taxed this industry. So everything was based on estimates. This was a whole new ball game here.

Senator Gage announced a fifteen minute break at this point.

Senator Gage called the meeting back to order.

Senator Crippen.

Senator Crippen:

Mr. Chairman, I'll tell you. I'm going to do something that I've thought about at length. Now, I'm going to extend my fellow legislators on the other side of the table over there a...I don't have an olive branch of peace, which I wish I did, but, in lieu of that I have something for you. In the words of Marie Antoinette... (Senator Crippen presented the conference committee members with a plate of cake.)

(Laughter)

Representative Kadas:

You are most gracious, most gracious.

Senator Crippen:

Thank you.

Senator Gage:

That was it?

(Laughter)

Representative Kadas:

But, we're getting someplace.

Senator Crippen:

That's certainly a start. I guess, Mr. Chairman, what I see we're boiling down to is an impasse on this thing. The impasse is about 4.5 - 3 - 4 million bucks,

A Committee Member:

$4.2 million

Senator Crippen:

...$4.2, and both sides have, I think, negotiated in good faith back in 1989, and I think both sides are cooperating..negotiating somewhat in good faith now, and we still have a situation that has come about that we often have in state government is that our estimates didn't hold true. And we're short. And yet, we have people that are going to suffer by that. And I think it's not responsible to let that happen. If that's actually the case, if we're going to be short this $4.2 million in the scheme of HB 28, then, I guess the only thing I can see is that we go to another source of funds. And that's the source that we would go to anywhere else if we're short. And I am just speaking for myself, and I guess that's the general fund. And we certainly did that in the past with...in our tax system. Maybe that's where it's going to end up anyway if we're going to be short. But I think this is the reality of life that there's a failure to peg a price or peg an amount, there was a failure to put an index feature in there, and I think that failure was done in good faith and it was just inadvertent and there it is. Frankly, I see no other way of going about doing it. So, I think we ought to go ahead and recommend that we...that both houses adopt the bill as it came out of the Senate. It takes care of the problems that we have with the stripper well gas exemptions, and it takes care of some of the other problems that we know we need to take of. It doesn't solve, particularly, the rates insofar as one side is concerned...where they feel it should be. But that is not so much in what they feel the rates actually should be, but it was based on the amount of income that you were hoping to receive. So there is no other way. I think that to resolve this problem...accept to go that. And I guess that would be the way that I'd recommend to my caucus that we do it. I, you know, see no other way at this point in time to do that. If that's,in fact where we are going to be short that money, then unless somebody else can come up with some other magical solution outside of this bill, you know, I don't see it.

Senator Mazurek:

Senator Crippen, can I just understand what you're saying? You're saying go to the Senate version but add an appropriation or something...that we do a budget amendment or..

Senator Crippen:

Yes, if we are, in fact, short. If it turns out that we are, in fact, short. And I guess this is what I've got from the testimony that we've had throughout this week. Okay, then, you know, I don't know if it was anyone's intention to be short, necessarily, back in 1989. But if we are, in fact, short, if it turns out that way, then the only alternative, if every party is willing to do that, that we're going to have to get the money somewhere else.

Senator Mazurek:

Okay, I understand that. I'm just curious how you propose to do it. Do you propose to...you would propose that the Senate bill as it passed in the Senate...and somehow..there's some sort of an understanding that the....

Senator Crippen:

Yeah, I'm just throwing it out, Senator. I think this is something that we have to discuss. Let's discuss if this is even feasible to do it this way.

Representative Patterson:

Senator Crippen, would your motion also include or feasibility to retain what the House Taxation did in Committee as a whole or a unanimous consent was to have the Revenue Oversight study the new methods of taxing coal, oil, and gas production that were mandated by the HB 28 special (unclear) '89 as amended by the (unclear) committe shall report its finding to the 52nd Legislature? (Unclear) that would give some sort of guidance or would that be omitted from your....

Senator Crippen:

Well, Representative Patterson, as you know...of the six of us here there are five of us that are on Revenue Oversight. And we know right now our plate is pretty full. I can't speak for the other members of the Revenue Oversight Committee, frankly, I think that we'd have that authority to do it if chose and we wouldn't need any legislation to do it. I don't know if... whether we can get that done in this short a period of time between now and the '91 session. You know, I think it might be a good idea because I think that it might convince some of our colleagues that, in fact, we are dealing with a real declining base and we've got a problem and we're going to have to look elsewhere. And so anything that would get us to that position, I'd go for. Whether we should do it now or not, I couldn't say.

Representative Kadas:

Senator, your proposal, then, is the House accede to the Senate bill and appropriate an additional $4.2 million this year for fiscal year '91 and that, somehow, that money be distributed. And then what about '92, '93, '94?

Senator Crippen:

Now wait a minute. Wait a minute. You're not talking about into the future because we're going to be doing that anyway. As I understand it, this amount, and maybe I don't grasp the problem as well as you do, Representative, but, as I understand it, it is for this biennium that we are short this amount. This is the amount that we are, in fact, short. And now if that's not the case, then maybe we don't need any ...an appropriation. But if we are, in fact, short, then I think the only other place to get it is the general fund and the mechanics of going about doing that, I guess I'd have to defer to those people who are on the Appropriations or Finance and Claims, of which I'm not.

Representative Kadas:

Well, I guess if you're going to do it this way, which I have some serious problems with, a) because you're increasing the deficit that we already face and I don't think that we ought to be doing that, b) if you use the same rationale, then next session it might not be $4.2 million, but it would be some fraction thereof that ought to be appropriated to these jurisdictions on out into the future forever until there is no more production from these resources.

Senator Crippen:

The rates will remain the same. I mean, you..we've committed to that. That if you pass this, do whatever we come up with here those rates are going to remain there. I guess what I'm saying is it's similar to the situation that if your income tax is not going to raise the money, you've already budgeted, you're going to have to come up with it somewhere. If the surtax is put on and it doesn't raise what you anticipate, where would you come up with the money? This is the same situation. And if, in fact, we are down this amount, then I guess this is the only way to put it, unless you have another way.

Representative Kadas:

I guess I'm looking for a little more long term solution and one that doesn't impact the general fund.

Senator Crippen:

I've given you one, Representative, and I would intend to do that next session as well.

Representative Kadas:

I'm certain that you will. I think you probably know what I'll do, too.

Senator Crippen:

Well, yeah, I hope, you'll give that plate of cake back to me, won't you?

Senator Gage:

Let me point out something you probably already are aware of. We've talked about are you willing to go halfway -- we already have gone halfway, folks. You all got this little green - semi-green sheet - (attachment #1). Look at the first column on the back page, it says LGST Current 27.7. If we do nothing, that is what is going to come in -27.7. We are telling you, with SB1 as it came over there, our production, our revenue, is down $80 - $90 million, but we're willing to come in and pick up another $4 million in tax, even though our revenue is down 80 or 90 million bucks. Because we made that deal in the '87 session and we're going to live by it. That's halfway, folks. We're not willing to go 100%. If you're willing to come halfway, we're willing to come halfway. If you're not....that's what I was taught negotiation is all about.

Representative Kadas:

Okay, Del. I guess the other end of the halfway is the 35.9. That's what net proceeds would produce for the next fiscal year.

Senator Gage:

No, that's not what net proceeds would produce for the next fiscal year.

Representative Kadas:

'89 production.

Senator Gage:

'89 production is not subject to net proceeds.

Representative Kadas:

Well, now, you know, I guess it gets back to the question of what is revenue neutral. I think that...

Senator Gage:

Oh, absolutely. I don't deny that. All I'm telling you is from where we came in here and where you guys are - you're saying to where we were before we came into session to where you want to be is 35.9 and 27.7. And people on your side of the aisle have said to me, "is there any room for movement on this thing?". And I said, "absolutely, we moved halfway on that thing when that bill went to the House". We moved 4 million bucks worth. We're asking you, now, move down $4.2 million and there we are. And I hear you saying, " we want that whole plate, we are not going to give you any of Senator Crippen's cake".

Senator Crippen:

It's fresh, believe me, it isn't stale.

(Laughter)

Representative Kadas:

I notice you haven't eaten any of it yet.

(Laughter)

Senator Crippen:

I'm on a diet.

Representative Kadas:

We don't know that.

Senator Crippen:

Trust me.

Representative Kadas:

I guess, Del, the 27.7, that's what you and the oil industry accepted as the starting point. That's not what everyone else accepts as the starting point, and I just don't think the House is willing to accept that the Senate Republicans and the oil industry ought to write this bill and that we ought to simply accede to that.

Senator Crippen:

First off, I think you ought to be careful. Senate Republicans...I think that - Senator Mazurek, correct me if I'm wrong - but the vote on this bill as it passed to the House was more than 27 -23. It was higher than that, wasn't it?

Senator Mazurek:

I'm sure it was.

Senator Crippen:

There were some Democrats that voted for it.

Representative Kadas:

Strike Republicans - say Senate. I mean, that's a more traditional opposition and...

Senator Crippen:

Oh, that's what we like....

Senator Mazurek:

But there is a certain amount of "let's be sure we keep the process going and keep bills moving and try to solve a problem".

Senator Crippen:

Something about (unclear) as I recall, too.

Senator Gage:

But Mike, you know the problem with your argument, Mike, is you want to say, "we didn't know where that figure was in the '89 session". And now you want to come in with hindsight and say, "here it is at 35.9, folks, and its...we've got to raise your rates to get to there". You know, that hindsight is a tremendous thing. Its a tremendous thing.

Senator Mazurek:

But it's being exercised by both sides. And you have to make that clear because otherwise there would be no proposal to make it revenue neutral at all. The question is revenue neutral to what. And I think you have an honest disagreement. Both sides recognize what we did in '89 didn't do what it was projected to do and so we are offering to make changes. It's a matter of degree.

Senator Gage:

That's true, Joe. But what I'm saying is we thought what we had was revenue neutral and it now shows that it would bring in 27.7. You're saying, "we thought it would be revenue neutral and it would bring in 35.9". We're now saying, "fine, let's split the difference, we'll come in with 31.7 if you'll come down to 31.7". None of us knew where it was going to be. I'll grant you that.

Representative Kadas:

31.7 is not in between 36.9 and 27.7.

Senator Gage:

No, I'm telling you where we are right now is 27.7. On what we knew when we were in here in '89 we are now at 27.7. Would you concede to that?

Representative Kadas:

That's what the local government severance tax is going to bring.

Senator Gage:

As this bill now stands.

Senator Mazurek:

As the law now stands.

Senator Gage:

As the law now stands.

Representative Kadas:

Yeah.

Senator Gage:

Okay, and that's all that we knew. And that's based on what we knew in 1989 at that session. What did you know other than that...what it would bring in?

Representative Kadas:

We didn't know what the local government severance tax was going to bring in. That's part of the problem.

Senator Gage:

That's what I'm telling you. This is based on the information that we knew at that time. We knew, that to be tax neutral, we had to be at the rates that we put in the bill based on the information that we had and that was converted from a net proceeds tax to the same revenue that a local government severance tax

would bring in on a basis of taxing the gross revenue. And we said, "that's where we're going to tax in the future". But, even if we didn't, even if we didn't, you're now saying, "well, we're finding out now that it would have been 35.9". And we're now saying, "well, we're finding out that where we thought it was going to be is only bringing in 27.7". And to go back to adjust our rates so that so that we would have, in actuality, brought in 40.4, we're willing to adjust those rates so that they pick up half of this difference between what the law says it will bring in and what net proceeds on '88 brought in. Even though we've got $80 million less revenue. We're willing to do that and come halfway by SB1 as it went into the House. You folks are saying, "well, we've got a little hindsight now, and we want what '88 net proceeds brought in". Even though - and I shouldn't make that statement and I won't make that statement because I'm not sure what the gross was in '88. I would get those figures, however, and my guess would be '88's gross maybe is higher than '89's, but I'm not positive of that. So I won't make that statement.

Senator Crippen:

Mr. Chairman, we may be at a loggerheads here. If that's the case, let's find out about it. But, you know, we're just sort going around robin now, wouldn't you agree? I think we've pretty well said everything that needs to be said and I have no illusion as to how my motion is going to end up. But I guess I would move, then that we, I don't how the mechanics would go, but request that the House recede from their amendments and the effect of that would be that SB1 would be recommended Do Pass - Concurred In - as it came out of the Senate.

Senator Gage:

You have a motion from Senator Crippen. Discussion on the motion?

Senator Mazurek:

Would you repeat it again, please? You go to 4.2 from...

Senator Crippen:

No, I'm not going to do that. I just said that we take it, SB1, as it passed the Senate. Now that does not include the Revenue Oversight thing and I think that's...you know...I'm ambivalent about that. Worry about that later, I guess.

Representative Kadas:

You're not...excuse me.

Senator Gage:

Discussion on the motion.

Representative Kadas:

You're not talking about putting it into the deficit or taking the money out of the general fund or...

Senator Crippen:

Not at this point.

Representative Schye:

Then what you're saying..you're...your motion and your negotiation position is just exactly what you passed.

Senator Crippen:

Yes.

Representative Schye:

No negotiation.

Senator Crippen:

Well, we've negotiated...I think we've gone through a lot of...

Representative Schye:

No movement from your side, no negotiation from your side.

Senator Crippen:

We've had a lot of movement.

Representative Schye:

Around and around. Not give and take.

Senator Crippen:

Up and down. I think Senator Gage has expressed it.

Representative Schye:

And again, I can express the feeling from our side that the give and take has all been between the Senate and the oil company and not the House. There's been no give and take between us and you're not willing to sit down and have give and take between us. We're here to negotiate. We're here to sit here and negotiate and try to get this done. But what I am hearing is, "you take what we give you, and that's it".

Senator Crippen:

What you're saying, then, is that the taxpayer, albeit the oil industry or anybody else, that will come in to negotiate has got to not only negotiate with the Senate, (unclear) something on there, and then they have to go back into another body and negotiate (unclear) different facts and figures and so forth...

Representative Schye:

That's the way the legislature works.

Senator Crippen:

That's what happened then...last...1987...I mean 1989. In the spring...in the special session. There was that negotiation. And I think Senator Gage has pointed out that we're willing to come up from that and as far as the deficit is concerned, I guess, I'd have to ask you, you know, and I guess I don't know how this would work. But if nothing happened - let's say we walked away from here and absolutely nothing happened and we were short whatever amount of dollars we'd be short. And yet we budgeted a certain amount and we at this point didn't come up...would that money be made up....

Representative Schye:

Lucky taxpayers (unclear)

Senator Crippen:

Well, listen, the taxpayers are everybody, granted. But also if you don't get enough revenue from other sources, from income tax, or whatever, the state has to make it up. Is this the same situation?

Representative Schye:

You're talking about making up a local shortfall with general fund dollars. If you don't make it up with general fund dollars and you don't make it up with oil money that was there in the past, then local taxpayers will make it up with higher millage.

Senator Crippen:

That being the case, then, I thank you for your explanation. I would be willing to, at least, recommend to my caucus my feelings on the matter and I may be alone. But if that is the case, I think it shows some good faith, some movement. And I would say that if there is that it has to come out of the state coffers. We..in HB 28...right or wrong, did a lot of changing in a rather short period of time, in a rather stressful, hectic period of time. And maybe this is one of the fallouts from that. Albeit, I don't want to see the local government people get hurt, I don't want to see education get hurt, and I think that was never the intent. So I guess that is where I'm coming from. Now that may be a simplistic point of view, Representative, but I guess that's the best I can offer.

Representative Kadas:

I can't accept it. I can't. I mean, it's....you know, you are, essentially, telling us, "you play our way or you don't play at all and if there is a problem, we'll fix it with the general fund". And I think that's irresponsible and I don't think you've got a way of distributing the money, either.

Senator Crippen:

(Unclear response)...I'm not saying there is.

Representative Kadas:

You're trying to find and easy way out of a problem that's a little more difficult than that.

Senator Crippen:

That may be, Representative, but at least it's a start.

Representative Kadas:

Well, let's vote on it.

Representative Patterson:

Just a minute. Before we go that far, I'd like to point out to the Senate members that in House Taxation, yesterday, we did have a lot of discussion on the

Revenue Oversight study. To study the process of taxing oil and gas. And we do have three members in that committee that were there yesterday and unanimously we all said, "yes, this is a crucial problem and Revenue Oversight should consider studying that". And that is in the bill, section 5. And I would hope that we would have some discussions on that because as Senator Crippen's motion is made, it may not pass. There may be a deadlock. We are not going to address that issue and I do think that we should consider discussing it here in the Senate. I realize you are on the Revenue Oversight Committee (indicating Senator Gage), Representative Schye is, Senator Crippen is, I'm on it, Senator Mazurek. I think this is (unclear) but we can't do it with this bill. We need to bring it up at the next meeting in June and say we feel this should be addressed and I have no assurances that we're going to do that.

Senator Crippen:

Do you have any problem with that?

Representative Schye:

No, none whatsoever...with bringing it up. It should stay in the bill.

Senator Crippen:

If you'd rather have it in the bill, that's fine, fine. I have no problem with that.

Representative Schye:

Let's vote on the motion. Question.

Senator Gage:

The question being called for the Senate members in favor of the motion indicate by saying aye:

Senator Crippen: aye

Senator Gage: aye

Opposed:

Senator Mazurek: no

The motion passes the Senate.

House members in favor of the motion indicate by saying aye:

Representative Patterson: aye

Those opposed:

Representative Schye: no

Representative Kadas: no

The motion fails on the House vote.

Senator Crippen:

Then, Mr. Chairman, anticipating that, I guess the only other thing that I can see that we can do here today is try to fix some of the things that we agreed upon in the past. And I'd asked Jeff Martin to prepare an amendment that we will pass out (attachment #2) ....do you have those.... that, essentially, what this does is it clarifies the application of local government severance taxes on gas stripper wells. Its essentially what, I think, SB4, did, when it was amended into SB1, and it just deals with the stripper wells, and it deals with some of the mechanics of the bill that have to be taken care of. And I offer that because, I guess, in all the hearings that we've had, I came to the conclusion that everybody agreed that part of the thing has to be taken care of. I didn't hear anybody say, "no, we ought not to do this". And I'm concerned that if we're at an impasse that reasonable men can differ reasonably, I guess, that at least what we should do is take care of what we all agree on. In fact, I would submit, it would be irresponsible not to do that, at least make an effort to get part of this thing done and take care of that oversight that was done in 1989. And so I would anticipate that this amendment would pass unanimously in this committee. At least, essentially, we're leaving everything like it is and we're taking care of these two little...these two problems.

Senator Gage:

Do you make that as a motion, Senator?

Senator Crippen:

Yes.

Jeff Martin:

Could I clarify? Based on the discussions, this amendment, in addition to reinserting this language strikes the study from the Revenue Oversight...

Senator Crippen:

Yeah, you know, we are all agreed, with five of us on the Revenue Oversight Committee, we can recommend to them that we start working on that. It might be an excellent idea and I don't think there is any disagreement so I don't see the need to put it in the bill. We can do that, we've done it in other areas without authorization from the legislature...in the bill. We have that authority and I think (unclear) should do it. I would go on record as saying that I would recommend the Revenue Oversight Committee get started on that.

Senator Gage:

Okay, discussion on the motion.

Senator Mazurek:

Mr. Chairman, I realize this is tempting, but I think it's a mistake. I've argued against that when this was first suggested in the Senate. The idea that everybody agrees there's one problem, I think, is not true. There are two problems. The Governor recognized that. He called us here to solve two problems. One being the stripper exemption, the other being revenue neutrality. Now, we may not agree on a rate shift, but I think to sever this thing out is a mistake. We've got a lot of other issues we're working on right now. I hope that we're not going to make the decision at this moment that there is an impasse and no resolution can be reached. I just think we need to reject it.

Senator Crippen:

We seem to be there, Senator. Looking at the last vote, we seem to be there. And I would hope that we're not trying to hold this hostage some way or another, because I think that would be foolish. I don't think that's the intent. It was my intent, when I voted for this thing to begin with, early on in the session, that let's get something through that we know that we can take care of and worry about... and then start zeroing in on these rates. If we can get something done fine, if we can't, fine. But whatever we do, we better not hold hostage these problems that we all agree with that have to be taken care of. And that's all I'm doing is I'm just saying, "we made an effort". I wouldn't have gone this way. I like the idea of strippers, separate them, to begin with but since we decided not to do that, it's here, we've made an effort to negotiate on this thing. It's failed. And here we are. And the only thing I can see is that we do this. Nobody is going to move.

Senator Mazurek:

Well, maybe that's the perception. I guess what I had heard the House say was that the House is willing to negotiate, but the Senate is not, except to take the money out of the general fund. I think that has problems, not the least of which is the deficit and trying to set up some sort of distribution method. So, I mean I have some thoughts, I'd like to play with some numbers, I think there's some give and take here, and I think....maybe I'm wrong, but I don't think people are willing to throw it all in at this point and say there is nothing we can do. There is an absolute impasse. I don't think we're at the stage where we can't accomplish....we may get there down the road, but not yet.

Representative Kadas:

Senator Crippen, it is certainly not the case that no one will move on this committee. I think it is the case that the Senate will not move. And this amendment is another example of that.

Senator Crippen:

Well, it's not intended to be, Representative. What it's intended to do, at least in my mind, is, I figure

we're at the loggerheads, and I don't want to leave here, and not take care of a problem that I think we all agree on. Maybe I'm not as realistic as you are, maybe I'm more so. But I think that's where we're at. (Tape is turned over at this point --narrative picks up with Senator Crippen continuing.) --and the next thing you know, (phrase unclear, mild expletive deleted) it's sine die and away we go. I don't want to see that happen. I want to see us, at least, get something done on this thing. Unless you have some problems with this...this...this..changing this, you know, and you haven't indicated that you have a problem in doing this, so I assume that you don't, and I don't think any of you do over there, at least that's my understanding, then I don't see the problem with going ahead and doing that.

Representative Kadas:

The problem I have with it, Senator, is that if we pass that then we will not deal with the rates at all, and that is a problem. Unless the whole package goes together, then we won't deal with a very important part of the problem.

Senator Crippen:

What I understand you are telling me then if--from the House's point of view, and their negotiation on this thing, and they're coming in to this table, it's the whole thing or it's nothing.

Representative Kadas:

It's deal with all the aspects of the problem. We're not saying what the rates ought to be, what the structure of the tax ought to be, we've given you our suggestions, that's in the House bill. I think that's what the House agreed to and we are willing to talk about that. All the various issues are in one bill as they ought to be.

Senator Crippen:

Yup - and I would like to see them go out in one bill.

Representative Kadas:

Good.

Senator Crippen:

I guess I am not feeling great about that, but I don't think it's going to happen. I think both sides have felt that they have negotiated and (unclear) and you know, I don't want to leave until I get something done. And I think Senator Gage pointed out very well what - the industry that he represents.

Representative Kadas:

Well, I...

Senator Crippen:

In fact, the industry that we all represent.

Representative Kadas:

I think you said it right the first time.

Senator Crippen:

You know, no, we all represent them, you better understand that. Because otherwise, we're in trouble. We just have differences of opinion, Representative, on how we represent, how we represent those interests. And I, you know, those may be reasonable, and I guess I assume that they are, and I'm not going to pound my hand and fist, on the table and say, well, you didn't do what we wanted to do, and you're not doing the same thing with us. I'm just saying lets take what we can get and we've made an effort.

Senator Gage:

Just to make a statement, I guess, before we vote on it. You may not class a royalty holder as part of the oil and gas industry. Those royalty interest owners, I think, feel like they're part of the oil and gas industry. And you need to realize that that $80 some million reduction in revenue is also is part of the royalty owner's reduction. He's not..he's not held harmless in this whole thing by a long shot. He's taking a...he's taking a hit on a share of that production decline and price decline whether you class him as part of the oil and gas industry or not. So we're coming in here and we're saying, "we've already increased taxes 8.3% on the royalty...on the royalty share of that oil...folks who have known royalty oil.

We've recommended increasing the royalty owner's share of 7.625% on the gas owner who is out there, and most of those folks will come in and tell you, "we don't like that - we'd rather be where the bill is now". And I don't blame them for that because most of those folks who had oil royalty - stripper oil royalty - went from an effective rate of about 15 or 16 or 17% or higher down to an effective rate on strippers of 4.2% under the bill - under the statute as it presently exists. So we're still giving those folks a decent break over what they were before, even though, from statute we've raised those people 8.3%. And those folks are taxpayers out there, too, I would remind you. That's not the state money, the only reason it's yours - or the state's - is because we've come in here and said we're going to tax everything we can tax in Montana, almost, at this point, other than the general sales tax. But we're already in here raising the rates on these folks on a declining revenue base, haven't suggested that on anybody that I'm aware of at this special session, but we're willing to do it on a declining base out there that's going to continue to decline. And to come in here now and say, "let's raise them higher than that", I think is saying to those industry folks out there, "beware of Montana, folks, because you're going --- you're going to get if you're coming to Montana". And those who are here - there's not much they can do about it. Just send some people down here who maybe will take a look at these kinds of policy issues in a different light than - tax things and the more - the less you make the higher tax we're going to place upon you.

Representative Kadas:

Senator Gage, how many times in the last ten years has this legislature reduced the taxation of oil?

Senator Gage:

Very few, now that you mention it. I'll remind you that back in about '80 or '81 the tax on oil was 2% on the first 150 barrels per well per quarter - 2.65% on anything over that. We went as high as 6% on state severance tax and..

Representative Kadas:

....and then reduced it..

Senator Gage:

and they've come back to 5%. Didn't even have the decency to stick with the deal we made with the local folks to say that was supposed to, you recall, fund the money they lost by going to a fee on automobiles, and those things. We went to a fee on that and we said, "now, the money that you're going to lose there and how you justify that and in God's name, I don't know". But we said, "we're going to double the tax on the oil and tax industry - more than double the tax on the oil and gas industry - for a period of time, and, and probably nearly double it, I would guess it's awful close to double it for the rest of the time to give you the amount of revenue that you are losing - you county folks, because of this". And we haven't even had the decency, with those local government folks, to do that. We even duped them out of that. Now, we came in and we said, "we're going to give you a twenty four month break on your new production". And that didn't - that didn't do a lot. I hate to tell you that, but it didn't do a lot. I would challenge you to go over to the net proceeds tax department and pull some of those net proceeds tax returns for the first two years on a new lease, and those people get the option of writing off their capital costs in two years or ten years against their net proceeds. Those who write them off in two years, generally, you will find, paid almost no net proceeds tax at all those first two years. So that out of the goodness of our heart, we say to those folks, "we're going to forgive you for two years a tax that you're probably not going to pay anyway". And we call that an incentive here in the Legislature. And then we did lower, and I would be the first to admit it, we did lower the tax on strippers and, in my estimation, it is good tax policy because I'm -- I don't know how long we're going to live, but I would bet you right now, if I live that long, and there is no way of proving it, but I would bet that you're going to get lower revenue, lower state severance tax revenue out of strippers at the lower rate, over the life of those wells, than you would have had you left that rate as it was on all production. And you may recall that the testimony that was given at that time was - it's the estimate of the industry people who are involved in that whole thing that just that difference is estimated to lengthen the life of those wells seven years. I don;t know how many of you remember that testimony, but I'm sure that whoever gave it can give you those figures. So when you're - when you're talking about tax breaks - compared to what? How do measure where it would have been without those? There is no way of doing that. You know we can say, "well, had this happened, this is the tax we would have gotten". Maybe it is, maybe it isn't. That's a guesstimate. Nobody knows what would have happened. So, I don't know how you measure that, Representative, I don't know how you measure that.

Representative Schye:

I think we can, we can talk all day on a lot of this stuff. There has been a lot of incentives given the oil company in the last two years. We talk about stability - most of the bills we've talked about in the legislature in the last few sessions have all been from the oil industry to change the stability. It hasn't been from people to raise it all the time. I wasn't here in '81. I wasn't here in '81. Ever since I've been here in '83 every - almost every single bill that's been here has been to decrease. A lot of those bills I supported. Some of them I didn't. But I think that if you take the add - the add from '81 and the one's that we've reduced - that it's more of a tax break than what you're saying. Now, we can get into that and we can argue that all we want, but we're talking about what's on the..the motion that's on the table right now. We can argue those at different times. I feel there are and you feel there aren't. So we could, we could, spend a lot of time there. But I always...continue on. This bill was put into the education bill, and again, tried to be taken out. To separate it because - and it was not allowed to be separated. And I'm sure you supported it not being separated out at that time. And we tried, many times, to separate that tax bill out of the education bill and it wouldn't - it was never successful to happen. This bill, if we do separate it now, the rates are lost and you talk about taxpayers - the taxpayers...there's not rates lost, the rates that are there are going to be there, we'll get the money. But the taxpayers that all of us represent, and I don't disagree with what you're saying, the taxpayers at home, too, the small business people, the farmers and ranchers, and so on, that we represent at home, their taxes will go up. So we have to do that. The House is willing to set here for as long as it takes to negotiate. Now we're at the loggerhead of what negotiations are, NOT what is there. You haven't proposed anything other than what you sent us. We're willing to sit down and negotiate with you with what we have put in the House and try to come up with a reasonable compromise. And so far, what you have given us, we feel, from our information, that we're about right. You feel that you're about right. We should sit down and try to compromise. I don't think we have negotiated. You haven't put anything on the table except your bill. That's not negotiation. Negotiation in the...or the... the definition of negotiation is give and take. There has been no give and take from this committee.

Senator Crippen:

Well, if I may, Mr. Chairman, I guess, you're right, it's give and take. I don't know about the House, but I know the attitude of the Senate, and even, sometimes, the Democratic Senate, is that when they submit a bill, it's submitted in good faith and as a compromise - a compromise bill. And that's what we have - a compromise bill. Now if we wanted to play the game here in this committee, if this was what we felt it was going to come to, sure, we could have come in with a - some figures that had been plucked out of the air, somewhat similar to what it came back to us from the House. But we chose not to play that game. And we're not playing it now. To say, "well, now we're going to play the game on the playing field that we - the House have laid out for us - with our proposal back to you and let's start working with that at that one end. And we're going to start with what you submitted which we feel is - was a compromise - at the other end and try to come somewhere in between is not the way it is going to be done, folks. That's not the way that we should do it. We did it, our compromise.

Representative Kadas:

When you sent the bill to the House, did you anticipate that the House would accept the bill with no amendments?

Laughter..

Senator Crippen:

You know, I'm the eternal optimist and I, at times, would hope that the House would...

Representative Kadas:

Senator, how long have you been in the Senate?

Senator Crippen:

Yeah, I know, you're right - in ten years I shouldn't wish those things.

Representative Kadas:

Has that ever been the case before? On an issue like this - ever?

Senator Crippen:

No, not even the feed bill, Representative.

Representative Kadas:

I didn't think so.

Senator Crippen:

Yeah, I know and I...

Representative Kadas:

I mean, if you were...really mean what you say, you are hopelessly naive.

Senator Crippen:

Yeah, and maybe I am. Maybe I should have just said, "forget it, folks, ..." well, in fact I did. I said, "let's send over this thing and get it taken care of and let's start negotiating on these rates as a separate issue and not tie one to the other". And I didn't want to move up this as a hostage. Well, I guess, being a man of good faith and high honor, that I think I am, that I wasn't about...I would have rejected the idea of coming in at some fallacious rate down below and say, "well, look, let's throw that out to these people, and they're going to reject it, and we know they're going to come back with something else, and they we can walk in on the playing field with ours down here and theirs up there, and we're going to end up where we wanted to be along".

Representative Kadas:

And Senator, I think we would not do the same thing either. I think we have a difference of opinion on what they ought to be. That is why we have a constitutional system with a legislature with two houses with conference committees.

Senator Gage:

Further discussion.

Representative Kadas:

Question.

Senator Gage:

Question called for. That did not include the study?

Senator Crippen:

No, it didn't.

Senator Gage:

Question being called for, the motion is to, or I guess I could basically say, take all of the rates out of the bill and address all of the other issues in the bill. Is that understood by everybody?

Murmured Assent.

Okay. Senate members in favor of the bill indicate by saying aye:

Senator Crippen: aye

Senator Gage: aye

Opposed:

Senator Mazurek: no

Senator Gage:

House members is favor of the motion indicate by saying aye:

Representative Patterson: aye

Opposed:

Representative Kadas: no

Representative Schye: no

Senator Gage:

Motion passes the Senate, fails the House.

Representative Kadas:

Mr. Chairman.

Senator Gage:

Mike.

Representative Kadas:

Senator Crippen, you, numerous times in the course of our pleasant time here at this table, mentioned the idea of indexing. And I...you said that ought to have been done, originally. And I guess I'm...I don't really understand what you mean by that. I wonder if you could articulate that and maybe there is someplace in there that we can find something.

Senator Crippen:

Well, Representative, what I meant by that was at the time when - I wasn't privy to your negotiations when it was in the Education Committee - but, where you were working on estimates and that one of the ways to handle the thing, if you were, I'm sure, as to where you were going, is that you would have set up a mechanism whereby if you had a set dollar figure that you could get to that. You didn't do that. You know. And maybe you should have. I'm not suggesting, necessarily, that we ought to go back and do that now. Because you have entered into an agreement way back then and that's....

Representative Kadas:

Well, but obviously, the agreement was relatively confused. If there is something with indexing, you know...I'm still not real clear on the mechanism but I would like to explore it, anyway.

Senator Crippen:

I don't even know if that's, at this point in time with this particular bill, you ought to be doing that. Because going back to what I think we talked about earlier, was that one side thought so much and the other side thought something else. And it didn't work out..

Senator Mazurek:

Mr. Chairman:

Senator Gage:

Senator Mazurek:

Senator Mazurek:

What time are we scheduled to go in?

Senator Gage:

1:30 p.m. (some discussion of time) 1:00 p.m.

Senator Mazurek:

Mr. Chairman, I'm....I think a recess might be helpful and I'd like to move that we recess subject to the call of the Chair, hopefully, sometime after....I don't know what we have in floor sessions, but, maybe our respective caucuses will want to talk...on the progress of what we've done so far...

Representative Schye:

Senator, we'll be available anytime you guys get done. I'll be around the halls.

Representative Patterson:

Mr. Chairman, is there any possibility that we could explore the possibilities of taking the $4.2 million from the general fund...maybe we could have the LFA's people see how that could be done. That might be one solution to this impasse, if we think the number we're hung up on is $4.2 million. Is there any way we can have the LFA try to come up and see how that...make this...can be done for distribution? Can you direct that to the LFA to help us out through here?

Senator Gage:

I will.

Senator Mazurek:

You might more properly direct that to the Council, I think, because you're talking about setting up a new (unclear) distribution mechanism...the dollars is not.... (minor amount of discussion by several legislators all at once)...they could work together.

Representative Patterson:

Maybe they could come back with an answer, whether that could be done, maybe that would be a...as Mike brought up, a good question...says it may not be done, it may not be. If it can, it may solve and impasse here.

Senator Gage:

Okay, I'll..if you will take that proposal to your conferences if you caucus, I'll relay that to LFA and Council and have them bring it back to us when we get back together. I'll let you know when...when we can get back to work again. Thank you.

The committee recessed and was reconvened at 3:07 p.m. by Senator Gage, Chairman.

Senator Gage:

I will call our committee meeting to order again. Would it help if we use these things (microphone system) for you folks who are here. (affirmative responses from the public). Okay. I got the right button this time. I guess we were nowhere this morning and here we are again. Anybody have a place to start they would like to start with particularly?

(Some laughter and remarks about the sound system)

Representative Kadas:

I just noticed the cake is gone. Trust me, again?

Senator Crippen:

The olive branch is always there, it's just in the refrigerator.

Senator Gage:

Well, to get things stated, I guess, I'm not going to give you any presenta..er, proposal, but I just want to point something out to you. Representative Schye, you are from Valley County?

Representative Schye:

That's right.

Senator Gage:

Okay, '89 - '90 mills, which is the year that we're currently in, according to the Department of Revenue handout I got, depending on which school district you may be in with regard to your royalty, based on 1988 production, those royalty holders paid from 16.5% to as high as 21.495% on their royalties. Currently, beginning with the payments that are due the end of May. So at this point they have had no tax break whatsoever. However, in statute, they have gotten a 50%+ tax reduction from what they paid in 1988. Now, secondly, all of the concern, or a lot of talk has been to the effect that these people, these oil industry folks, are no longer subject to those escalating mills and everybody else that's out there is going to pick those up. But I also, I guess, would point out to you that those royalty holders on their royalty income are also not going to pick up those escalating mills. And no question they have some property on the tax rolls yet that are going to. But I would also point out to you that the oil and gas industry folks have, on a statewide basis, about a $180 million worth of property on the tax rolls that are going to be subject to those mills in the future as well.

Representative Schye:

We're not talking Valley County.

Senator Gage:

For what?

Representative Schye:

$180 million.

Senator Gage:

No, totally, - statewide.

Representative Schye:

We switched from county to state - or from county to statewide - fairly loose there.

Senator Gage:

No, no, that's a statewide figure. Sorry about that. That's a statewide figure - $180 million. Just as a spot to get started from. And we have, we have other millages in other areas and I think the smallest one that I've seen in the areas that have oil and gas is, I believe, Bighorn. No, here's the smaller ones here. Phillips County has some people who are down in the 14% range and on gas they're getting a little, over net proceeds, they're getting a little bump. On oil, those folks are, even under this bill, compared to where they have historically been, at least, where they were in '88, are getting a tax break. So, whatever value that may be to you, if none, you have it anyway.

Representative Schye:

Well, I guess just to respond a little bit, that is an area in my district - that's in the northeast, or in the - yeah, it would be the northeast corner of my district, the Luster oil fields. I would guess, and I can't - don't - have the figures in front of me, but the majority of the landholders there are also royalty holders. Most of the land up there was homesteaded in about 1915 - 19-, between 1915 and 1920, by the Mennonites and that land is very - has not changed hands very much. In places, I'm sure it has and I'm sure there is royalties. Their mill levies did go up an awful lot with the additional 40 mills plus the other mills that are going to take to keep the Frazier school district going. So I think there is, probably, a substantial increase to those. Now, when we hear royalties at 70%, and again, I can't argue that, but up there my perception and from the royalty people I talked to up there, they're saying don't put it on their backs. Make sure the oil industry pays some, too. And I, you know again, I think they should and we didn't hear a lot from the royalty people. I've had calls from royalty people and I think, probably, you have, too.

Senator Gage:

Yes, I have, Representative, and without exception, I have told every one of them you ought to be tickled to death with this bill and will those rates because you're getting a tremendous tax break. And some of them won't believe that but (it's a) fact. All they've got to do is take a look at the mills.

Representative Schye:

You're right, a lot of them don't believe it.

(Pause in the discussion)

I'm sorry, are you done?

Senator Gage:

Oh, yes.

Representative Schye:

Okay, Senator, we're...members of the House...and as we said before, we were talking about possibly negotiating and sitting down and trying to figure something out. I guess you weren't willing to put something out. We, we, we feel our numbers are correct, are right, and we can justify them. I think this morning we sat down and tried to justify them to you - we've justified them to ourselves and justified them the best we can to you. But we're willing to sit down, throw out a proposal to you, and see where you would come at with that proposal.

Senator Gage:

Comments? From anyone?

Representative Schye:

Now, if there's not - if you don't want to listen to the proposal or you're stuck on yours, that's fine. But we will try to come out - we feel we're negotiating in good faith, we're open for any suggestions from you. As somebody said, we're at a logjam, we're willing to try to come out, hopefully maybe break that. If not, I want to hear a - I would very much like to hear a proposal from you and hear something a little different.

Senator Gage:

Okay, go ahead.

Representative Schye:

(unclear)..go with ours. Bruce, get your pencil out.

Senator Crippen:

I can't write that fast.

Representative Schye:

It's not, it's not very extensive. Okay, now, we're talking rates. I'll go through the rates. Anybody has any questions or anything, they can stop me anytime they want. On the oil rates, the operator - 8.4%; the stripper - 6.3% - that's a 3/4s - that's a break from the effective rate they have now, we feel that's quite a substantial; the royalty operator -8.4%; the royalty stripper - 8.4%. Down to the gas rates. Now a lot of these - the oil rate was right out of some of the bills that have already been introduced. The gas rates - the operator at 17.4% which is your - the original Gage bill - it's there; the stripper at 17.4%; the royalty operator at 17.4%. Total - that comes up to a total of $34.4 (million).

Senator Gage:

Would you run those oil again?

Representative Schye:

8.4% - regular operator - 8.4%. The stripper would be 3/4 of that or 6.3%. The royalty operator - 8.4%. The royalty stripper at 8.4%. The gas rates - 17.4% straight through. Now I would hope that from a position of this - of throwing something out - that we could get some debate, get some talk, and get a counter proposal. I think the House has done everything that we can to try to come out, negotiate, and I would hope the Senate would do the same.

Senator Gage:

Okay. Comments from anybody in regard to their proposal?

Senator Crippen:

That's an increase of $2.7 million.

Representative Schye:

No, no Senator, it's a decrease from $35.9 (million).

Senator Gage:

What did you say that raised, Representative Schye?

Representative Schye:

$34.4 (million).

Senator Crippen:

You didn't like my phraseology?

Representative Schye:

No.

Senator Gage:

I guess the only...the comment I would have, I guess, is that the stripper gas doesn't make tax policy sense. To do anything to differentiate those rates in the mind of you folks?

Representative Schye:

Well, Senator Gage, a lot of the information we had and a lot of the people that were talking to us - gas is, gas is sold from the well - or natural gas is sold from the wells at different times of the year at different rates. There are also gas lines that come in from different areas. Gas lines can be controlled very easily. And the same rationale we had this morning on the gas wells being the same, the oil wells being the same, that there really, in most of our minds, there is not much of a difference between a stripper gas well and a regular gas well. They can be shut down and opened up with the information we have.

Senator Gage:

I guess what you're saying is the operating costs shouldn't make a lot of difference on the...in the gas area?

Senator Schye:

Right.

Representative Kadas:

Well, and also, I think you went through - you told us a nice story about the problems of shutting down an oil well and then starting it back up again. And I think we acknowledged that with oil - with gas it's a different story.

Senator Gage:

I guess probably the comment I would have is on historical - or at least on '87 - on the basis of '87 and '88, as far as that goes, but '87 even before there was those increases in millages, the royalty folks in the oil area and in the, to some extent in the gas area, are still getting a pretty decent tax break. And I guess I don't....

Representative Schye:

Now if we take, we take these numbers, the 8.4%, of course that - on the oil. Well, let's go back to the gas. I'm sorry. The gas is off your original introduced bill. If fact, we lowered it from your original introduced bill. It was, in your original bill, it was introduced at 17.4% - 4.4%. And If you look down at, Senator Gage, Senate Bill 1 as introduced of 17.44%. And we rounded that off or put down 17.4% and again the rationale for the stripper gas wells and so on. The oil at 8.4%, again that's what current is now. The stripper well, instead of going half, we do recognize some stripper well considerations there at 3/4. Royalties, where a lot of us are having problems, would stay the same as the gas, or as the regular rate.

Senator Gage:

Okay. Do you have any figures as to what this would have raised based on 1987's production?

Representative Schye:

No.

Representative Kadas:

No, all we have got is what it will generate on the '89 production. If you want to get that we can get it.

Senator Gage:

Okay, yeah, that would be interesting to see.

Representative Schye:

I think, Senator, as you know, the workers' comp bill is going possibly, and I think that we can sit and negotiate, we can take breaks, but I would hope that the Senate will continue to negotiate and - or start to negotiate - I'm sorry, and try to come up with something that we can all live with. And I think we have made a good faith start when we came and now we have been, again, to make that good faith effort again.

Senator Gage:

Well, we appreciate your good faith.

Representative Schye:

Thank you.

Senator Gage:

For the record. Yeah, if we could just stand at ease until they - or would you like to take a break for twenty minutes or - how long will it take, Terri, do you have any idea?

Terri Cohea, LFA:

About ten minutes.

Senator Gage:

Ten minutes? Okay, let's...unless there is something else you'd like to talk about while they're gone.

Representative Kadas:

Well, do you have any other questions about what we're, kind of, putting on the table here?

Senator Gage:

No, I don't have. I guess the only other thought I've had with regard to strippers is that in excess of, as I indicated in the committee, we've got a handout to indicate how many stripper wells there are out there - oh, I'm sorry that I didn't give you guys copies of those - this is a - and I only have three of them. This is a print out based on '89 production as to the number of wells that are stripper compared to the totals in the state (attachment #3). There's about..or the number of leases that are stripper in the state... and as I recall, there's about 3000 leases in the state of Montana so you can see...

Some garbled discussion:

oil, 3000 wells,

Senator Gage:

Oil and gas.

Representative Schye:

Oil and gas?

Senator Gage:

Yes, gas is the first column, oil is the second column. Based on '89, that's about the number of stripper leases in the state of Montana. And based on the number of wells, I think you'd find it's considerably higher percentage of that because many of these leases have...we've got leases up in my country that have 20 wells on them. And the lease - and maybe some with more than that, I'm not sure about that, but I know we've had some with that many because I kept a set of books on one that had 26 wells on it. So, as a percentage of the total wells, I think you would find that a much bigger percentage of the total wells are stripper than leases. And I mention that to you because, to some degree, these stripper wells are the only thing that's keeping some of those service interests for people in the state of Montana. Many of them have left. I think there is only one full time, with any kind of office at all, in Montana...oh, I guess, two, I think Haliburton still has one or, maybe, two yards in Montana now. And we have one other operator that's still hanging on up in Cutbank. But most of those folks have left the state. We have almost nothing in the line of, other than Haliburton, I don't think we have anything in the line of a major well service outfit in our whole area any more. And we have probably 90%, I would guess - or maybe more than that even - of the stripper wells in the state of Montana up in our area. So, to that degree, the strippers are extremely important to the state of Mont...to the total oil industry. (tape change, two or three sentences lost)

Senator Gage continues at beginning of third tape:

..operating those wells. If they were up to 10 barrels, it would be a far different situation, from my perspective, at least, as far as strippers than it is when they're down at - some of them, half barrel - and they produce those wells because they have 20 or 26 of them on a lease. And they can, they can, they now have most of them to the point where they're producing into common batteries and those kind of things so they can go around and pump those wells reasonably well. And in the combination of that many wells, come up with - out of 20 wells - oh, maybe -15 to 16 barrels a day production. But the problem with looking at strippers in that regard is the fact that we say they're only 8.22% tax on a statewide basis. That's throwing all those fellows - folks - who are close to 10 barrels - it's like saying you can't drown in a river that averages 6 inches deep.

Representative Kadas:

But Del, at some point, I mean, I think the whole process here in the drafting this bill has legitimized the use of statewide averages. And at some point you've got to say yes. I mean, you were willing to say yes at 4.2% - I guess, I guess we're saying 6.3%. I mean we split the difference with you on that one. It may, in fact, put a stripper or two out of business. On the other hand, how much, how much inducement...you know, it's going to be a fairly significant tax break for a lot of other strippers...and it's just...you know...

Senator Gage:

Well, I don't know that I would say that it's going to be a fairly substantial inducement for a lot of strippers...

Representative Kadas:

Well, it's going to be a fairly substantial tax break for a lot of strippers. I'm sorry.

Senator Gage:

Some tax break for some strippers. And I don't think it's going to be for a lot of strippers.

Representative Schye:

If it's an average, it's got to be something.

Senator Gage:

Well, no question about that. And that's all we can work with, is averages. But I'm just telling you the reason my perspective is different than yours. You know, you're worried about the royalty owner in your area, and you want to keep his tax down as low as you can keep it down. And you're saying to your people in your area, "we want a 50%, or more, tax break for you royalty owner who have no costs at all on your production". But yet you're telling me "we're only want to give your stripper fellow a 25% tax break compared to where everybody else is on his actual costs". And he's got all the costs of producing in addition to that. I guess that's fair from your perspective...got a little ways to go on mine.

Representative Schye:

We talk fair up here a lot. Are we going to take a break, Senator?

Senator Gage:

Oh yes, sorry about that. If you want to take a break, we sure can.

Short break taken until 5:05 p.m.

Senator Gage:

I would call our Conference Committee back to order. I'll give you my assessment of, excuse me, I'll give you my assessment of your proposal and, I guess, ask you a question. And depending on the response, give you a response to that, and go from there.

(Laughter)

Senator Mazurek:

You haven't figured what happens after that?

Senator Gage:

I'm not sure what the two responses are going to bring out. First of all, the 8.4% on the operator interest on oil and the 8.4% on the royalty interest on oil make no sense whatsoever. You know, we're telling the guy with no costs at all, "you should pay the same percentage of your gross as the guy who pays all the operating costs". It makes no sense whatsoever. I can understand what you're talking about with the strippers. But for the little guys up in my country, that doesn't make a lot of sense yet, either. And I'm to the point, right now... I've been trying to work on things that would make sense for the whole oil and gas industry and for the tax structure of the state of Montana. But, I'm getting to the point now where I've got to start looking at what's good for my area, what's best for my area, as well as the state of Montana. Emphasis, maybe, on my area, at this point. 17.4% on all gas is crazy compared to '87. Those folks on regular operators were at 16% under net proceeds. They were 1.4% better off under net proceeds. The stripper operators were 6.15% better off under net proceeds on this thing. The royalty owners get a marginal .47% reduction. Now compare that to the oil royalty fellow who goes from 14.72% to 8.4%. And I realize that, most of the time, fairness and equity and even a semblance of relatively close to what was happening before maybe doesn't wash in the Legislature all the time. And I don't, you know, I understand where the proposal comes from. We're sitting here with...from the Democratic side, with two people who have no oil or gas in their area at all, who really aren't concerned about what happens with this thing as far as their district's are concerned, except to the extent that it affects the foundation program. Now that might not be fair to say....

Senator Mazurek:

I'm representing my caucus...not necessarily (garbled) representing the views expressed in our caucuses...

Senator Gage:

Oh, I'm sure that's true. I'm sure that's true. And perhaps that's where you're coming from - your whole caucus, but I can't believe that your whole caucus thinks that it's fair to tax an operator who pays all of the operating costs the same as a royalty owner who has no costs at all. I cannot believe that your caucus feels that that's the route to go in the state of Montana. So, from my perspective, I can't see that your offer makes any sense at all. And my question to you...and if you'd like to comment on that, any of you, go.

Representative Kadas:

Well, Del, I guess we think it makes a little more sense than that. I, we, appreciate the fact that you looked at it. If you don't think that it makes sense, then, I guess, we would appreciate something that you thought did.

Senator Gage:

Okay, that was the second part of the thing...

Representative Kadas:

Was that the right response?

Senator Gage:

Yeah, that was the one that I needed a response to, I guess. Yeah. Is there any possibility that either of your caucuses, House or Senate, are willing to look at oil royalty at 12.5%? (period of silence, no response) If you're willing to look at that at 12.5%...and when we started out...or the word that came to me was that if we could get back to tax neutral '87 based on the amounts that that would have raised on the original bill, which was about $1.5 million long, we could probably work something out. If we can get to 12.5%, and I don't know where we'll make the changes yet, we haven't worked that far on this thing to see where we could increase anything to come up with that $1.5 million, we'd have to do some juggling among other different royalties and working interests and strippers and whatever else, to see if there is any way we could come up with that..with that $1.5 million....

Representative Kadas:

Del, I just want to...I'm not clear on what $1.5 million you're talking about.

Senator Gage:

Oh, okay. The rates that I had in the original bill raised, instead of $40.4 million, raised $41.9 million. That's the $1.5 million based on '87's production. And I was told that if we could get back to that area somewhere we might be able to work something out. If you're willing to look at a 12.5% oil royalty rate, I would be willing to work with some of these other rates and come back with a proposal as to where we might be able to go with those to come up with the $1.5 million over what Senate Bill 1 went over to you folks, raised, which was $31.7 million.

Representative Kadas:

Okay, so if I can, if I can put it in a different fiscal year, what you're saying, your two points are, maybe there's more points than that, but, the one's you're set on are oil operating at 8.4% , oil royalty at 12.5%, and for fiscal year '91 revenue $33.02 (million), which, I think is equal to your introduced bill.

Senator Gage:

$33.2 (million)

Representative Kadas:

$33.2 - is it .2? So, are we on the same wavelength?

Senator Gage:

We're on the same wavelength. And as I say, I'd offer you that as a start. And as I say, assuming we can work something out on these other rates, that they're not a complete brick. And I'm not sure if we can. Senator Crippen.

Senator Crippen:

You're the oil...you're the expert.

Representative Kadas:

Did you have something, Bruce?

Senator Crippen:

I don't like it, but (garbled) you're going a little too high. He's going a little high and I think you guys are way too high. And that's why I haven't said anything. I'm just one player out of six. It's just, you know, I....

Representative Kadas:

Del, if I could ask you then, since Bruce is not going to tell me..no, you did, you did. What are your thoughts, then, on gas?

Senator Gage:

Gas and oil, we'd have to, that's where we'd have to look at those rates and see where we can adjust to come up with $1.5 million. On the balance of those oil and gas rates.

Representative Kadas:

What about the relationship of the rates between the operating interests, royalty, and strippers?

Senator Crippen:

Look, let me tell you this, you know. I'm aghast, you know, I...15.25% is absolute..absolute madness, as far as I'm concerned.

Representative Kadas:

I'm sorry.

Senator Crippen:

On regular gas 15.25% is...the max. That's, you know, I think anything more than that...you'll find it just isn't going to work.

Representative Kadas:

Senator...oh, I'm sorry, go ahead.

Representative Schye:

No, I was going to say something to Senator Gage. I think we're, we're, we're throwing around a lot of numbers. Now, if we thought there was a way to get out of here tonight I would say let's stay here all night and do it. We have workers' comp in conference committee, we have this in conference committee. We're all coming back in. You give us a proposal, whichever way you want it written, tomorrow. Then we will take that proposal and take it under advisement to our caucuses and then we can come back with that answer for you, Senator Gage. Is that fair enough to you?

Senator Gage:

Yeah, excuse me, yeah, that's fair with me.

Representative Schye:

I mean, you can put that at your 12.5% for your royalties. You do what you want to come up with your $1.5 million and you give us that full package in the morning and we can...we'll see what we can do from there. It's hard to..it's hard to figure, well, we'll put the gas at 15.25% or we'll put it at here...it's hard for us to agree on one segment of it only.

Senator Gage:

Yeah, and that's why...that's why I asked you first, and I didn't get a response. And that was my..that's why I said I want to ask you a question first and then I want a response and then I want to give you another response to that. And I first asked you , "are you willing to consider going back to 12.5%'? And had your answer been, "no way", then that would have been one thing. Had you answer been "sure, we'll consider it", then I would have finished my response. But I didn't get a response the first one, so I thought, well, I'll give you the rest of the story, I guess.

Representative Schye:

Senator, I think we're willing to consider anything that you will bring forward to us in a complete package. We will look at that and then we will come back and maybe it'll have Bruce's numbers in it. It'll have your numbers. But if you come back with that in the morning in the conference committee, something that we have written down for us, in a proposal, and something we can take back and say, "here it is", that we will go with that. Now, I am not saying that we will go with <u>that</u>, we'll go with that to our caucuses and discuss it amongst ourselves, amongst the people that are involved in it, and go from there.

Senator Gage:

I'm not..I'm not sure that I can put that kind of thing together that will fly with oil and gas industry people in total. Particularly in my area, necessarily. But I'm willing to work on it overnight and see if I can get any kind of consensus out of those folks as to where those rates might be if we...if we put another $1.5 million in there with royalty...oil royalty at 12.5%. And if I can get any kind of consensus at all, I'll bring you back a proposal. If I can't, I'll bring you back a second proposal that is the worst of all worlds for all of us in Montana, I guess.

Senator Crippen:

I won't get into that. We may get to that. We're obviously getting into that area now - living in Yellowstone County, I don't have much of an area.

Representative Patterson:

(garbled) ...those wells in Yellowstone County are in my district..

Senator Crippen:

Are they in the eastern....?

Representative Schye:

We would appreciate you coming back with your proposal, a written proposal, that has everything down for us so that we can look at it. We can discuss that. We can go from there on what we're going to do. It's hard, it's hard to pick one out at a time, and I think you understand that.

Senator Gage:

I understand that.

Representative Schye:

And maybe we can go along with some of the areas, maybe not. And that's the part...that's part of the process. You get that, you get that together, if you can, and come back tomorrow morning. We would appreciate that.

Senator Gage:

I'll do my best, Representative Schye. Anything else anybody would like to comment on or recommend or...?

Senator Mazurek:

What time do we go in?

Senator Gage:

We go in at 8:00 a.m.

Senator Mazurek:

Let's come in early.

Senator Crippen:

No, ----, I'm going to work out on the stair machine.

Senator Mazurek:

Well, I mean, after that. What time do you get done?

Senator Crippen:

I get up at 4:00 a.m and I go down and start working out until.. (discussion becomes garbled with everyone offering a different idea for a meeting time)

Senator Crippen:

Is that Conference Committee on workers' comp...are they going to have anything done by tonight?

Senator Mazurek:

They're probably going to work tonight. Which is what we probably ought to do.

Senator Gage:

Well, if you'd like to come back after supper, we'll try and get something put together between now and then if you want...

Senator Mazurek:

I don't think it's worth coming back unless you're going to have a proposal ready. It's going to take all night.

Senator Gage:

Oh, it won't take all night, I don't think. It's just a matter of putting some proposals together and getting a hold of people to see what reactions are.

Representative Patterson:

Let's say 8:00 p.m.

Senator Crippen:

To come back here? It's only 5:30 p.m. We can come back here by....

Senator Mazurek:

How long will it take you to get a proposal ready?

More garbled discussion of time frames...

Representative Kadas:

I'd just as soon wait until tomorrow, but if you want to come back tonight, that's fine, too.

Senator Gage:

Whatever the wishes are - I don't have a preference, personally. Everybody fine with like 8:30 in the morning?

Senator Crippen:

You're a young fellow, you ought...

Representative Kadas:

But, I've got to get a lot of sleep, Bruce.

Senator Gage:

On recess of both houses in the morning?

Representative Kadas:

Okay.

Senator Gage:

Thank you.

The Conference Committee adjourned until 9:00 a.m., Friday, May 25.

Senator Gage:

We'll call the hearing to order and ask the Secretary to note the Conference Committee members who are here.

All members were present.

We did a lot of work and a lot of phone calls and a lot of other things last night. And we're hear and ready to go this morning and Senator Crippen has some stuff he'd like to talk about.

Senator Crippen.

Thank you. Mr. Chairman, I'd give you some figures that you wanted. This is a little bit of frosting on the cake that I offered yesterday.

Representative Kadas:

Is it low cal?

Senator Crippen:

It's sweet and fattening. Regular...let's talk about the oil rates...regular, non-royalty oil rates, these are operating rates, 8.4%. Stripper, non-royalty, which is now at 4.2%, we'll raise that at 5%. Then into the royalty area, both regular and stripper would be 12.5%. Then into the gas rates, everything would be 15.25%, with the exception of stripper non-royalty, which would be 10%.

Representative Schye:

Say that again, I'm sorry.

Senator Crippen:

Okay, everything would be 15.25%, with operator non-royalty stripper -- I mean operator stripper - or your non-royalty, however you want to phrase it - at 10%. Now according to our calculations, ...

Senator Mazurek:

A lot of us have been working off the LFA sheets, and I'm not sure what your 15 applies to and what your 10 applies to...

Senator Crippen:

Well, I...

Senator Mazurek:

Is it 10% applies to stripper, and then the royalty rate would also be 15.25%?

Senator Crippen:

Okay, look under the LFA stuff, you're morning of May 24th (attachment #1), under natural gas, regular is 15.25%, okay?

Senator Mazurek:

Both strippers are 10%?

Representative Schye:

Not both strippers...

Senator Crippen:

No, just one stripper, the other one we took out. Then royalty is 15.25% so..

Representative Kadas:

Royalty on stripper and regular gas is 15.25%.

Senator Crippen:

That's correct. Okay, according to my figures, that will bring you in roughly $33,400,000. Why don't you look at that a little bit and see what you think.

Representative Schye:

Is this your offer here...or is this what you're saying we ought to go for on the...I want to know if we're supposed to just look at it or....

Senator Crippen:

Oh, I, you know, I didn't propose this thing for my health. I mean, this, this is it.

Representative Schye:

Okay.

Senator Crippen:

No, I'm not, I'm not quite as...I'm easier to get along with than the Chairman....(two people talking at once)..reasonable...and you know, well, I realize he's a gentleman on the surface.....

Laughter

Senator Gage:

Just like Mr. Dangerfield, I don't get no respect.

Representative Schye:

Senator, let me, let me run through and make sure I've got it written down right, here. You've got 8.4% for the gas, or oil, I'm sorry. 8.4% for the oil, 5% for the stripper on the oil, 12.5% for the royalties - for the royalties on..on the oil.

Senator Crippen:

Um hum (affirmative response)

Representative Schye:

Okay. The gas is 12.25% regular....

Senator Crippen:

No, no..it's 15.25%.

Representative Schye:

15...15.25% for regular, 15.25% for stripper...

Senator Crippen:

No, No, 10%. That's under operator. You got...we're talking about the operator gas first. Working interest gas. Regular gas is at 15.25%, stripper is at 10%. Then the royalty is all at 15.25%.

Representative Schye:

The only thing that's at 10% is stripper operator.

Senator Crippen:

That's correct.

Representative Schye:

That's where I was (unclear) down wrong.

Senator Crippen:

Yeah, that's sort of consistent with what was in the net proceeds...I mean as far as the breakdown. Now, the, and I'm a little bit rough on my figures...I don't have them exact as to the....

Senator Mazurek:

Have you got those numbers? (addressed to Terri Cohea). Mr. Chairman?

Senator Gage:

Joe.

Senator Mazurek:

I guess..could...could...I assume that the LFA has run those numbers. Would it be objectionable to you if we asked her to comment on the...just on the bottom line?

Senator Gage:

No..No..you should have a sheet on those already.

Representative Schye:

No, we don't.

Senator Crippen:

Well, okay, just..whatever. What do you come up with?

Terri Cohea (LFA):

Mr. Chairman, we need to run just two numbers to get to this option (rest of sentence unclear).

Senator Crippen:

I can give it to you.

Laughter

Senator Gage:

If you want to just stand at ease for a second.

(The tape continues to run for a few moments as the recorder was not shut off during the break.)

Senator Gage:

Could I ask you to turn your speakers on so the folks, they said they can't hardly hear you in the back. They're somewhat a player in this whole thing process, I think..

Unidentified Committee Member:

That's why we were whispering.

Laughter

Unidentified Committee Member:

I'm afraid you're right.

Representative Kadas:

Okay. Just so we're clear, then, clear on the rates. The proposal, then, is for $32.6 (million) plus $800,000 interest.

Senator Crippen:

Yeah, $840,000, whatever it is..you know, depending on how many days you need to distribute...

Representative Kadas:

Pardon?

Senator Crippen:

It depends on...it's going to vary on days because you're not going to have the entire interest retiring, you have to interpolate.

Senator Gage:

Might..might indicate to you that that's based on this first year in that they anticipate some of those first payments because of the fact they'll have to go back out for royalty information may not come in until the end of July. Normal years that interest would be closer to $950,000 or $960,000.

Representative Kadas:

Well, I guess, a question, then, maybe, for Terri (Cohea. When figuring, I think on this sheet (attachment #1) where you go with current local government tax, 27.7, is the interest included there?

Terri Cohea (LFA):

Mr. Chairman, Members of the Conference Committee, no, this sheet, none of the totals included interest. These are tax collections only. So they would be comparable to the $32.63 million number for the option that has been laid before you this morning.

Representative Kadas:

Okay. When..when we came up with the $35.9 million number for net proceeds generated in fiscal '90, is the interest included in that number?

Terri Cohea:

Mr. Chairman, Members of the Conference Committee, under the net proceeds system there was no interest. The payments were made twice a year instead of quarterly. They were made November 30 and May..in May..and distributed then. So there was no interest involved in the net proceeds.

Representative Kadas:

Okay, so by going to the flat tax we are...just the transition to the flat tax will generate an additional $800,000 because there will be interest?

Terri Cohea:

Mr. Chairman, Members of the Conference Committee, yes, because, again, it's quarterly payments rather than the two semi-annual payments. There is interest earned on the money held until it is distributed. And under the terms of the current HB 28 that interest is to be included in the distribution to school districts and local governments and university system.

Representative Kadas:

Okay.

Senator Gage:

Would you like to caucus or anything or...?

Representative Kadas:

I think that we would. First of all, I guess, I passed around another amendment (attachment #5) as we start discussing and...yeah, this is by no means an agreement to go a separate rate on royalty owners, but I think I, in particular, and probably most of our caucus, are concerned about the ability of a taxpayer to move from the royalty rate to the working interest rate. So I'm trying to...this is something I asked Lee (Heiman) to draft, I think, last Monday. So I would want you, at least, to consider that amendment. Just that I want to get it up here while we're talking about things so you have a little time to think about it. And if you have any comments on that right now, I'd sure be interested in them. But if you...

Senator Crippen:

Oh, I...Mr. Chairman, I don't know about you...Mr. Chairman, I..you know this is...let's work on this thing here first, then we can discuss this. You know, I want to have a chance to look at it..that's my...

Representative Kadas:

Well, I guess, I guess, my willingness to go to a separate rate on royalty is going to be tied to your willingness to go to kind of strengthening the language there so..you know, you can think about it later on if you want to. I'm just kind of giving you the opportunity to think about it now.

Senator Crippen:

Let's don't tie willingness to willingness. I think that the real key...at least I assume the real key is the replacement of monies that was lost and not..not something like this...

Representative Kadas:

Senator Crippen, the real key is making sure that the money is there and will be there over the long term. And if there is a legal loophole then the money isn't there over the long term.

Senator Crippen:

Well, if we're worried about the money is going to be there...there in the long term, we...we can spend the entire day talking about that, Representative Kadas. And I'd be delighted to do that with you.

Representative Kadas:

Well, I think we did that yesterday.

Senator Crippen:

Yeah, and we can do it again today, if you like. If you..if you feel like have the need to caucus on these figures I that I've given you, fine. Go right ahead. We'll be here.

Senator Mazurek:

Mr. Chairman, it's my understanding that the workers' comp conference committee intends to work for about an hour and then the committee members will all go to their respective caucuses and report back. I assume that's what we intend to here as well.

Senator Gage:

If that's your choice, Senator. We can sure do that here.

Senator Mazurek:

Isn't that your intention in the House? To take this back to your caucuses?

Representative Schye:

That's right. The House is going in at 10:30 a.m. and probably we will caucus then. We will discuss this between now and then and probably in the caucuses and come back with that. I would hope that you would look at the amendment that's there, also, in between that time.

Representative Kadas:

Make it 11:30 a.m.?

Senator Crippen:

We've got a whole day...until tomorrow.

Representative Schye:

Or do you want to make it afternoon?

Some general comment...

let's go...11:30 a.m. would be fine.

Senator Gage:

Okay. We'll..we'll recess, then until 11:30 a.m. Thank you.

The Conference Committee recessed and was called back to order at 11:30 a.m. by the Chairman, Senator Gage.

Senator Gage:

Maybe the first thing we need to talk about, inasmuch as an indication was given that the proposed amendment may have a lot do with where we go from there. And I'd like to give you a presentation and get some reaction. Apparently, or I think, at least, all of us seem to have confidence that Terri Cohea knows what's she's doing down here. I certainly do. I hope the rest of you agree with it. In fact, I recommended Terri for a (unclear - sounded like "total") fellowship, which is a tremendous honor. There are 32 people in the whole United States who are selected for this..for this honor, and Terri was one of those 32. So, she's...her, her credentials on a national level are pretty high. But I would like to ask her a couple of questions. And I didn't tell her the questions before I got up here. But I told I her I was going to ask her a couple.

In your flat tax...or in your presentation to the Legislative Finance, Terri, you brought up the possibility, and I think maybe even in your flat tax presentation, that there may be conversions from royalty to working interest in order to get under lower rates. Did you talk with anybody in the oil and gas industry before and get any kind of comments from them before you discussed that whole thing?

Terri Cohea:

Senator Gage, Members of the Conference Committee, yes, I did. I talked with Tom Richman, the Administrator of the Board of Oil and Gas Conservation. I also called the Petroleum Association and discussed it with them. Maybe I should give a little background. This was about a week and a half before the special session was to begin, and given how short the special session was going to be, I didn't want to surface an idea on the first day of the special session and have everyone have to react to it. So I brought my concerns to the Department of Revenue and to the Petroleum Association. After I spoke with the Petroleum Association, Janelle (Fallon) had Jack King, from Billings, give me a call. I ran the idea by him. He faxed up some copies of the..the..like Black's law dictionary but for the oil industry, with some definitions. Mr. Richman, from the Board of Oil and Gas, agreed that there was a real possibility there could be conversions between the two types of interests. Mr. King told me that overriding royalties could be converted from a royalty interest to a working interest during the terms of a lease. And that..that the thing that governed that was the terms of the lease itself.

Senator Gage:

Okay. One other question, Terri. In that whole conversation did anybody talk about the possibility of a difference in liability of a working...of converting from a royalty interest owner as far as environmental issues or...or problems that a well might create for a working interest owner that a royalty interest owner didn't have to face?

Terri Cohea:

Senator Gage, Members of the Conference Committee, the discussion...as I remember, no one raised that issue. The discussion was principally sharing of costs. Mr. Richman felt that a lease could be structured so that there would be a limited exposure to costs under the working interest. We did not discuss environmental issues.

Senator Gage:

Okay, thank you, Terri, I appreciate that. (End of tape.)

...would make sense under this...and I think this scenario...I didn't...I just ran it under one...and I just picked numbers at random. And I'm not sure under what percentages this might hold but I...I have it in a...in the back of a black mind at this point that this would probably hold for...regardless of the percentage of royalty or the level of production. So, if..if I could I'd like to put those...and run through this scenario..and if you'd comment on the likelihood of a person making that conversion with regard to what this shows I'd appreciate that. Also, you need to...you need to keep in the back of your mind, I think, another thing with regard to this liability. We have, as I understand it, in Montana, and you folks who are lawyers know a lot more about what this does than I do. But, I understand we have a joint and several liability law in this state whereby, though you might only own one percent of something, you could be stuck for 100% of the damage. That's...I don't know that that's accurate, but that's my understanding. So let me...let me give you this scenario and get your reaction to it.

(Senator Gage used the chalk board to illustrate his comments.)

Now as I indicated these are just...I just picked a spot to start from...I didn't...I didn't even know where I was going when I started with the thing but... Let's say a guy has a lease that produces 24,000 barrels of oil. And..and let's assume that this is a stripper well, even, or stripper lease...all...the total...total production qualified for stripper rates so that...and I use that because it would...that's the biggest spread. You know, you gain by converting from a 12.5% royalty to a 5%..or even a 4.2% stripper working interest owner. That's a fair statement? Would you say...as our rates are now? If you're going to convert, converting from a 12.5% royalty to a 4.2% stripper is the biggest spread you could hope for. Okay. Let's say a guy has got a 24,000 barrel well - produces 24,000 barrels a year. He's going to get...right now about $17 a barrel for that oil. My figures say $408,000 total value of that product. Okay. This guy has...owns the total royalty -12.5%. So he's going to get 12.5% of that royalty amount...$51,000? Okay. Under our present...under our present proposal 12.5% tax - $6375. $6375, okay. Now the guy goes to the calculator and he said, "man, I can gain a 7.5% tax advantage on this dude if I can get that operator to agree to let me pay some operating costs to convert that to a working interest. Okay, 5% under our proposal? Everybody buy that? Okay. At 5% mine says $2550? Difference - $3825.

Unidentified remark -- "we trust you, on that one".

Okay, now, the guy goes in and he says to the operator, "I'll give you 1 cent a barrel". Well, let me go to a different one, first. Based on the 240,000 (Senator Gage said 240,000 although he was referring to the 24,000 number) barrels that we've got here that's being produced, this guy is going to save 16 cents a barrel on...on his tax. You divide the $3824 by the 24,000 barrels and he's going to save 16 cents a barrel. Now, I used the 24,000 because if he becomes an operator, he's going to have to pay the operating costs on that full 24,000 barrels, not just his royalty share...on that full 24,000 barrels. Okay? So, if he goes in and says, "I'll give you a penny a barrel if you'll let me convert to a working interest. That's going to cost me $240." Everybody go along with that? "I'll give you a penny a barrel. And I'm saving 16 cents a barrel, here, so I'm going to make 15 cents a barrel by converting to this thing." I don't...there...there might be some operators that would take him up on that. I don't think for a penny a barrel. Here's what can happen to the operator. He's now got another owner in his property. So for a penny a barrel, $240, he's stuck with..with justifying to that new working interest owner everything that he does with his well. In addition, he's got to furnish that guy with statements on that well whenever that guy wants them. I'm not sure $240 is going to entice this guy to do that, this working interest owner, to do that.

Senator Mazurek:

Del, if that's the case, why...I mean, if it's not going to happen, why do you object to the lang...why, why would there be objection to some sort of language that would just ensure that..

Senator Gage:

Why put it in the...why put something in statute that's..that doesn't make any sense at all, Joe? And this makes no sense at all. That's why I want to bring this whole scenario out to you. Why garble up our...our...you know, everybody says, "if it isn't broke, don't fix it". I want to tell you, folks, it isn't broke and it's not apt to get broke. If it does, 10 years down the line, or 15 years down the line, when all this production is gone....you know it's not going to happen then.

Representative Kadas:

I guess I'm kind of convinced for...that..that your scenario is probably accurate for the kind of people that you work with. Landowners that have a royalty interest and it's not big. The case I'm worried about is where you have a large corporation that has a large royalty interest and a large operating interest, like Meridian, where they could make the conversion, conceivably, and receive considerable benefit from it. And...that..that's the one that I'm really kind of worried about.

Senator Gage:

That may well be possible. And they could do that, I'm sure. I guess I wouldn't worry about that, Mike, because I'm told that from the past....anyway, so much for this..I can tell you about a lot of other reasons for this but I hope you got the drift of this thing. For most people, you might get an isolated situation out there, I don't think you're even going to get that. But, regardless of that, I hope you got the drift of that thing.

The other thing - I'm told by the Department of Revenue that...that Meridian has never segregated their...on their net proceeds tax they have always reported theirs as working interest. Didn't really make any difference there because they are at the same rates either way. They may well do that. I'm not sure about that. I can't tell you whether they would or not. But, I think they're pretty good citizens, personally, and... But the guy who owns both royalty and working interests, there's no question...and that's probably Meridian almost totally in Montana, from my perspective. There may be a few others out there. We have some people up in my area that...that the mineral owners decided they were in an area where they were being drilled all around. So they said, "well, why should we lease our property out? Why don't we develop it?" And they no longer own it because production got down to where it's...they didn't want to mess with it. But it would have benefitted them because then they're under no more environmental risk that they were before because they were in both spots. And that may happen, and you're exactly right. For those folks who have both working and royalty interests, and that's primarily Meridian, it could happen. There's no question.

Representative Kadas:

Okay, and I guess that's what I'm concerned about. And maybe I can start from there and give you our response to your proposal this morning which... First of all, I want to say that we appreciated after yesterday...I think we made more progress in a half an hour this morning than we did in eight hours yesterday. It was a joyous occasion for me.

With regard to the...First of all, on the amendment that we've just been talking about, I guess. That is still important to us. The Department of Revenue has suggested some changes in the language and I think Lee (Heiman) has those. I'll just read...it's all in the last line and it would read, "liabilities of a majority of the working interests in the operation" instead of "ownership interests in the operation". (see attachment #5) Okay, that's the first point.

Second point, with that, we're willing to somewhat reluctantly settle...agree on your oil rates...and our biggest problem is with the..the royalty rate. We have talked long and hard with some members in our caucus and they have agreed to go along with that. So we'll accept your oil rates. On the gas rates, we still believe that the rates ought to all be the same rate. And what we recommend is a rate of 13.6% for regular, stripper and royalty. That whole package, then, would generate $33 million before the interest payment.

Senator Gage:

Okay..would you..sorry, sorry, Mike, would you give me those numbers....royalty or oil all the same...

Representative Kadas:

Oil is the same.

Senator Gage:

Gas...

Representative Kadas:

Gas - put everything at 13.6%. And then that gives you a total revenue package of $33 (million) plus the interest, which I understand is around .8 ($800,000).

Senator Gage:

If anybody else have a comment? Without thinking further, I'd invite you to...I have a couple of comments right off the bat. So what I hear you saying is, "we're willing to give you royalty...gas owner...gas royalty owners a 3.27% decrease in your tax, but we want you stripper producers who pay all the costs to pick up 2.35% tax".

Representative Kadas:

That's right.

Senator Gage:

Does that make sense to you? And if it does, how in the world does it?

Representative Kadas:

Guys, I think what...the reason we wanted this...I guess if you're really insistent on having a separate royalty rate on the gas as opposed to the operating rate. You know, we've given on that on the oil and, I guess, you know, we may have some room to move there. We do think that the stripper rate on gas ought to be the same as the regular rate. And, I think we went through that earlier about...that..that the process of operating a gas well, particularly the difference between a stripper well and a regular well is a little more than changing the valve. And we really would like to remove the incentive for just changing the valve to receive the lower rate of taxation. That...that's why we were willing to lower the regular rate on gas.

Senator Gage:

Do you recall a presentation I gave in House Taxation, Mike, with regard to what you stand to gain and lose by manipulating your production?

Representative Kadas:

If you want to go through it again, I'm sure...my memory is "sloggy" at this point.

Senator Gage:

Okay. I gave you a scenario that said you get maximum benefit from the taxation of gas if you're at exactly

60,000 cubic feet a day...yeah, 60,000 feet a day of production. That puts you under the maximum lowest rate you can get and stay...because of the stripper situation. Now, if you go to 70,000 a day, you get..you end up with more net after tax by paying the higher rate than you do by losing 10,000 a day production and paying the lower rate. Okay. There's a spot between 68,000 and 69,000 that you're dead even - don't make any difference. You're going to get the same revenue whether you...whether you pay stripper rates at 60,000 or whether you produce 68,000+ and pay the higher rate. You end up with the same net after tax. Going down the other way, the same thing applies. If you're at 60.1 (thousand barrels) a day, you end up with the same net at the higher tax than if you're at 50....than if you're at 52.2 minus. At the lower rate you end up with the same net. In between there, there is no question. In between...in between 60.1 and 52+, you're better off not being at 60.1 and being somewhere in between that range. But if you overshoot, and you get below that 52+, then you start costing yourself money even assuming you could have produced that 60.1. You're costing yourself money even though you got into the lower rate because you're....you're losing more on your production than you're gaining in tax benefits. So, all you're talking about is an extremely narrow band in there and..and you've got to manipulate that a year ahead of time. You've got to anticipate weather conditions, you've got to anticipate what's going to happen with your wells, both oil and gas. Oil's the same thing except for the difference...the difference there...I'd have to get my...my sheets for sure to see where that...where that fell on oil. It seemed to me it was at 11....

Representative Kadas:

That's okay on oil.

Senator Gage:

Okay.

Representative Kadas:

We've given you oil.

Senator Gage:

Okay. Same..same thing applies to oil, however. But there's a narrow band in there where you get a benefit, but it's...it's so slight that I can't imagine an operator saying, "you know, I can save a cent or two here in tax if I manipulate my production and...I'm not saying there aren't some who may try it...but, I'm telling you, those folks are playing with dynamite if they try it because they've got...they've got to do that a year in advance. They've got to anticipate weather, they've got to anticipate market conditions, they've got to anticipate what's going to happen to their wells, whether....You know a lot of times things happen to those wells that you don't have any control over. It isn't just a matter of turning the valve off. That production might stop, whether you like it or not, for several reasons and I am sure there are gas operators out here who can give you a lot of horror stories about that. But it isn't just a simple, Mike, as turning off the valve to manipulate your production. You might get your production lowered whether you like it or not. By Mother Nature - by whoever. So, it's..it's...there's a lot more to this thing that just saying, "I'm going to shut my valve off to get down to stripper status". And even if they do, you're talking about minuscule amounts.

Senator Crippen:

Well, Mr. Chairman.

Senator Gage:

Senator Crippen.

Senator Crippen:

Members of the Committee, I appreciate your comments and I'm going to be giving you mine. I'll be very direct and to the point. I am not going to accept, from my standpoint at least, nor will I recommend to my caucus - number 1, your proposal on the amendment to handle whatever it is on the conversions. Period. It flies in the face of this whole thing. I don't like it. I think it's a witch hunt. I think you've demonstrated it and I think, in fact, you went too far in demonstrating it because I think, Terri, if you...had mention that she...we're talking about overriding royalty interest, I've not seen too many overriding royalty interests that would exceed or would be up in the 12.5% area. Overriding royalty interest is a carved out interest. 12.5% is the landowner's interest. And, boy, a landowner is going to think long and hard before he or she is going to switch under that. And now, I might be willing to look at it and address the concerns that we agreed to address in

Revenue Oversight Committee, and if that's where it should properly be. But that's where I am with that, now, and if that's going to screw things up, then so be it, that's where it is.

As far as your rates are concerned, I think that Senator Gage pretty well adequately expressed the opinion, I think, of himself and myself, Representative Patterson. When you want to cut gas production in this state, and do like others like others in this body have attempted to do in the past, and we're about to risk of being political, we have a Senator would love to do that, squeezed the goose that laid the golden egg until there wasn't...pluck it's feathers until it was naked...then, that's what you should do. But I'm not willing to do it. We've come a long way. It's time for lunch, I'm going to go to lunch. And I'd suggest that you guys do the same. Maybe go back to your people and we may get something done this afternoon or we may not. We've got one more day left and we are heading to that day, and that's fine with me. But you better well know where we're coming from right now. And I've given it to you and, as far as I'm concerned, that's where I'm going to be. Mr. Chairman, I would move that we adjourn for lunch.

Senator Gage:

Comments? Questions?

Senator Crippen:

Well, you can vote against my motion. I think we should just...you know, we know what they're going to say and they know what I'm going to say and you better think about it over lunch.

Senator Mazurek:

Bruce, could I?..I guess what I don't understand about your...the hard line on the amendment is that...I understand the concern on the small interests, but I thought Del said that in terms of some of the larger working interests, he admitted that it could be a problem. I don't understand that.

Senator Crippen:

He admitted that it could be a problem, okay? We are trying to attempt..or attempt..handle a problem in a short period of time that didn't surface before.

It didn't surface last summer. All of a sudden the thing surfaces. Because....

Senator Mazurek:

What...who...why did it surface, though? It's because you have different...now you have different rates.

Senator Crippen:

Yeah, but we don't know what the ramifications of it. And before we start putting these restrictions on agreements, we better look at the ramifications. We better have people come in to the Revenue Oversight Committee, and as I said, five of us are on there. And I'm amazed, Representative, that you wouldn't want to do that. That we would have the opportunity to look at it. Senator Keating has got some problems with it now...and other people that are familiar with the oil bus...or are involved in the oil business. And for us to, right here in this short period of time, and say, "well, we're going to put this restriction on". No way. That's not the way to go about doing it. We're talking about rates. And that's where I want to keep it. Right at rates. We have some other problems. We got another body to handle that and that's the Revenue Oversight Committee. And as I pledged to you before, gentlemen, we're willing to do that. We're willing to take the time, the Revenue Oversight Committee, to do it. And this could be one of them. But, I'm not about to recommend that we do anything on this at this time, right now, that is just, to me, not the way to go about doing it.

Senator Mazurek:

I guess, though, my only concern about that...you may well be ultimately right on that. But it's...it's been thrown out here for the first time this morning. If there are major concerns, let's talk about whether changes in the language that would be necessary. I mean that...it's...it's sort of all of a sudden (unclear but sounds like "that's the hard line..in the sand") and it's all because of this language and nobody's even talked about it. And Senator Gage, just five minutes ago, said, "yeah, it could be a problem". And the Legislative Fiscal Analyst has been saying since we came in there that this might be a problem. So..

Senator Crippen:

There's a lot of things that could be a problem in a lot of areas. And for us to try to handle a problem right now, at this stage of the game, with the little knowledge that we have,is not the way to go about doing it. Now, you know...and you know that, Senator. We should...if we're going to have this prob...if it really is a problem, well, let's look at it in Revenue Oversight. I'm not trying to delay the problem or give somebody a leg up. But I'm trying to do it in a responsible manner and to sit here, in this Conference Committee, and try to handle the problem, is not the way to go about doing it. And we know that.

Senator Mazurek:

The other side of...I think the reason for the concern is...that if it's a matter which is going to have a significant impact on the numbers, we ought to know that. And we ought to try to address it. Maybe...once these numbers are in, we can't change them again.

Senator Crippen:

I realize that.

Senator Gage:

Who said that?

Senator Crippen:

Well, don't..hate to admit it that they would never change them again.

All talk at once.

Senator Mazurek:

They're going to go into effect on July first and let's...

Senator Gage:

We can't change then until December...until January, whatever.

Senator Mazurek:

That's right.

Senator Crippen:

When the government starts to interfere or to stick it's fingers into contracts that are dealt with at arm's length in the business sector, we had better look long and hard before we agree to do that. And that's what we are doing here now. And I'm not saying that shouldn't be done. And I'm not saying that there isn't a problem or there might not be a problem, but I'm saying that let's look at it. This is not the place to do it...I'm not willing to do it here. I'm willing to do it in Revenue Oversight, but not here.

Representative Kadas:

Senator, my concern is that if someone is going to do this, they're going to do it rather quickly, because they see the opportunity. And it's...it's easy enough for, I think, the entity that we're particularly talking about to change their contracts in a very short period of time. Now if it makes it any easier for you, I'd be willing to sunset it.

Senator Gage:

Well, Representative Kadas, did you bother to ask Meridian if they have a contract with themselves on their wells?

Representative Kadas:

No, I haven't.

Senator Gage:

Do you think they do have?

Representative Kadas:

I have no idea.

Senator Gage:

Where they own both the royalty and the mineral interests?

Representative Kadas:

Senator Gage, I..I don't know, but I...

Senator Gage:

So this talks about a con..or agreement. Now if they don't have an agreement, what's going to stop them from doing it anyway? You know, they own them both anyway. What's going...how you going to stop it when there's no agreement there?

Representative Kadas:

Well, then, I guess we've got another problem. I mean, you raise an interesting possibility.

Senator Gage:

That proves Senator Crippen's point.

Representative Kadas:

Well, if that's the case, then our numbers are wrong that we've been dealing with all week.

Senator Gage:

Yeah, those numbers may well be wrong for a lot of reasons. No question about that. But the other problem I have with this thing is, let's say, we have folks out there who aren't both...don't both own royalty and working interests. As I read this, you're saying, "we don't care what you've done with your agreements. Regardless of that, we're telling you that you can't change the effective rate unless you can come in and substantiate it". You know, who is going to pay all those costs of substantiating all of that?

Representative Kadas:

The person who wants to change it.

Senator Gage:

Yeah.

Representative Kadas:

That's right.

Senator Gage:

You got that right. So, here we are saying to that guy, "in addition to the fact that you made a good faith agreement with somebody, in the past, to change...to convert your interest, in addition to that, you may well have a good business reason for it, but we're going to put you to all the expense and trouble, (and it really rings in my ear of the lot...of a lot of what we have under the Environmental Protection Act), we're going to put you to all the expense and the trouble and the costs of substantiating to our satisfaction (speaking as the Department of Revenue - and we've had some fairly hostile folks in that Department of Revenue in the directorship) to our satisfaction that you should be doing that. Even though you have a contract that pre-dates what happened here, pre-dates '88 - December '88, you're still going to have to justify that." I'm not sure that, and Joe probably has a better understanding of that and Senator Crippen, than I do but I'm not sure but what some lawyer might have a case against the state of Montana saying, "you're infringing on my contract rights".

Representative Kadas:

Well, Senator Gage, the other side of it is, to me, we have an obvious loophole in what we're discussing here and if someone creative enough to take advantage of it, does take advantage of it, then, the rest of the taxpayers in that jurisdiction are going to have to pick up the bill. So, you're putting costs on someone else if someone...if we don't treat this particular taxpayer in terms of what we are defining as fair. If that person is able to get out of that, then everyone else got to pick up the costs.

Senator Gage:

Sure, and if that guy can do that, Mike, and bring in more revenue so that the taxes on those taxpayers can go down, he should not be precluded from doing that and he should not have added burdens and costs and stumbling blocks put in his way to be able to get that done.

Representative Kadas:

If the point is...doing it...is to gain $3000 so he can get that much more profit or maybe it's $3 million, you know, you don't that it's going to be reinvested in Montana or anything else. The point is, we're trying to make a law that treats royalty owners in a particular way and I think we ought to stick with that.

If we leave a loophole so that they can just get out of it, then I don't see what the sense of having this separate rate is.

Senator Gage:

Well, the sense is, if we're going to address it, let's..let's address it to where it makes sense. You're...you're whole problem is concerned with Meridian at this point, as I understand it, where those people who own both royalty and working interests. And right now, you're probably dealing with an entity that has no agreement at all and your whole thing talks about an agreement. So you better, you better come back with..in with different language, which we probably aren't going to like anyway, or you better agree to Senator Crippen's proposal to put it before Revenue Oversight. Let them look at the other things we don't know about what's happening with this thing and come back to the '91 session with something that's had more than a half hour's study.

Senator Crippen:

Well, you know, Mr. Chairman, I'm just going to have to make a comment about loopholes. You know, I'm not saying that loopholes don't exist. I don't say this is what you would classify as a giveaway loophole. I'm not saying that it is or it isn't. You know, but, to cavalierly go along and say, "boy, these people are getting one big loophole, here, and we're giving it to them", is nonsense. Because it doesn't...the facts don't show that out. We haven't seen the facts yet. We don't know what the facts are. And for somebody, for a business person, or anybody, to minimize...to minimize their tax liability, would you say that that's a loophole? If I can put income from one year into another, in a legitimate fashion, but the net result is that I may pay less taxes overall, is that a loophole?

Representative Kadas:

It's a loophole if the intention of the Legislature was to tax them on a particular rate and they aren't taxed at that rate because they have....

Senator Crippen:

(interrupting..) sound, good business sense, is that a loophole? If that's the case, Representative, you better look at your tax codes, because we've got loopholes everywhere. Everything is a loophole.

Representative Kadas:

You're darned tooting and I'd like to close a few of them.

Senator Crippen:

Well, you know, we're talking about two different wavelengths and I don't.. (several remarks at once, garbled)

Representative Schye:

I..I'm not going to continue that..that line of arguing at all. We're not going to go...right now, we'll go back - you guys go back - let's get back to the rate part on the gas. Now we heard, we heard Senator Gage - I want to hear a little more justification of why. Now we're hearing from gas people who live in the gas areas. They're drilling new wells. They're cranking the old ones down. They're becoming stripper wells. We're hearing that from all kinds. How do you justify that and not having...they're getting the lower rates if they got this zero exemption by turning the wells down. And we're hearing all kinds of things like that. We've not heard the justification for one tax rate that is actually still lower, has a lower effective rate than it would have been under the net and gross proceeds on that...or on that...on that gas in the past. So it still would be lower. Only one rate. And so far, you know, we hear, we hear a little bit on the marginal and stuff...The oil wells, we agree, you convinced me. You did a good job. I agree with you on the oil stripper wells. Many of us do not agree on the gas stripper wells. It's too easy to manipulate that because of weather, because of the pipeline capacities, and many other things with new oil...or new gas wells coming in. And they...and the pipeline capacities. So those can be turned up and down, and so on. Now, I understand some of it you're saying...but you haven't convinced us. And I guess we need to be convinced - or you need to be convinced - that there has to be some movement there on that gas part of it.

Senator Gage:

Well, Representative Schye, all I can tell you is the figures that we got from the LFA , and that we got from everybody else, that shows that in 1987, and I think you could go to any year you want to pick that there's net proceeds tax, and find that the stripper operator has paid a lower rate on gas than the regular operator under net proceeds tax. And we're converting...you'll back on the language of HB 28, "this is a tax in lieu of net proceeds tax". No question, we're not going back to exact rates, but that variance is still there, whether it...The fact is, those operators on stripper gas wells paid a lower effective rate on their gas than those operators on regular gas wells. You know, I don't understand...I guess that's as plain as I can make it.

Representative Schye:

But you're saying the incentive is there to crank them down, then.

Senator Gage:

No.

Representative Schye:

You..you mentioned that when I said something about...when I talked about them drilling new ones and cranking the other ones down. The new ones go under the new production rate, that we're not even talking about at all. The old ones are now, all of a sudden, put into stripper categories.

Senator Gage:

Yes.

Representative Schye:

That..that rate went down quite a bit. Fairly significant in a lot of our areas. But those...the other wells were paying the older rate and with the exemption and stuff and a lot of the other things, those wells went down.

Senator Gage:

I guess I'm not following you, Ted.

Representative Schye:

Well, we're trying to find a justification that we can take back and say that there is. That you can justify to me that...that they don't do that to get the lower tax rate. We're lowering the top...the effective tax rate on the top quite a bit. If you noticed that. It's quite a ways down..15.995%...we're taking that down to 13.6%. That's quite a savings for the people that are producing regular gas. Don't you agree to that?

Senator Gage:

Sure, I agree, and those aren't the folks that need help. That's our problem.

Representative Schye:

You take the stripper people up..up to that little..that little bit which we're going up. The effective rate is 11.25%...we go up to 13.6%. So we've got a set rate for gas.

Senator Gage:

Sure.

Representative Schye:

Now I would like you guys to discuss that. We will discuss the other and discuss stuff...see if there is any way that you can either convince us or come up with something else.

Senator Gage:

Well, we can't convince you, Representative, when you're of the opinion that it makes sense to give a guy, who doesn't necessarily need a tax break, a tax break and raise the guy who does need the tax break. It just makes no sense at all.

Representative Schye:

Well, I guess...I guess, then, you're right. I'm not getting across. A lot of the ones I'm talking about are owned by one company, where they come in and drill the new wells fairly close to the stripper, or the old wells that were producing wells. Now, they're cranking those down. We're not talking about two different entities, we're talking about the same entity.

Senator Gage:

Well, but you're having an effect on everybody when you're doing it. You can't isolate somebody out there. You've got to look at the affect you're having on everybody in the state of Montana when you do this. You can't isolate your situation and say, "we'll fix you, buddy".

Representative Schye:

Senator Gage, it was your statement yesterday to talk about your oil wells in your district.

Senator Gage:

And my gas wells in my district and not the oil wells and the royalty holders (interrupting each other - garbled)

Representative Schye:

....so know it's different to when I bring it up. It should be statewide. When you do it, it should be your district.

Senator Gage:

No, I'm fine statewide. I'm willing to stay...and we're still at statewide averages. I'm telling you the effect on my people and I'm telling you the effect that's going to have on the whole state. And I'm willing to look at statewide averages, which we are doing. And I'm willing to look at statewide averages in regard to what you're saying as long as you're willing to say, "this is what's happening to my...to the folks in my area...but also I'm willing to look at the whole statewide thing...in concept of the whole statewide thing". That's what you're not willing to do.

Representative Schye:

That's to your advantage.

Senator Gage:

Well, I'm looking at the whole thing. If you want advantage for my area, I'm willing to go back to net proceeds tax and so are the people in my area. And I will pledge to you, as I'm sitting here right now, that if we can't come to something relatively quickly, my folks are saying, "we've had all we can stand on our strippers up here, (and I represent those folks in my area) and we would rather have you go to net proceeds tax than to put a higher burden on us". And I talked like a dutch uncle last night to convince some people that we might have to go to 5% on strippers and we might have to go to 10% on stripper gas.

Representative Schye:

As we did also, talk like dutch uncles, to the people we have to work with in our...in our areas to come up with some of the agreements we had. And so I don't think that...you know, that..you working real hard, I understand that. But I think the consideration should be given here of how hard we're working with our people and what the taxpayers and stuff that we're working with also. And getting mad at each other doesn't do us any good at all.

Senator Gage:

I'm not mad at you. I'm just talking to you about it.

Representative Schye:

No, I mean, when we started, I realized we...we raise our voices once in a while and things like this. But, I don't...I don't want to see a wreck right now. I want to see progress made on this. I don't think we're that far apart. I think we're fairly close. I think, if we're still willing to sit down and negotiate and figure some stuff our, we can. I don't think either one of us should say, "this is it - we're not willing to do any more". I think we should. If we're in that mindset, we're in bad shape.

Senator Gage:

From the perspective of the people in my coun..my area, then, we're in bad shape. Because that's the message I was given. "We would rather have you back to net proceeds tax for us, in our area, than..." And I would hate to see that happen, I really would, because I think the best thing that could happen for the oil industry in Montana, and for the state of Montana, is flat rate taxes or I wouldn't have worked my buns off this thing. But, I'm also representing the folks in my area, as you folks are, and to go back to stripper - or to go back to net proceeds tax is beneficial, at this point, for the folks in my area, and it's detrimental for the folks in your area. And that's the crucial point we're right at now, as far as I'm concerned. I'm ready to go back to net proceeds tax for the benefit of the folks in my area. I've got people paying taxes in my area who weren't paying under net proceeds tax. And they're hanging on by the skin of their teeth, in those half to two barrel wells.

Representative Schye:

We're not talking about oil wells, now.

Senator Gage:

I don't care what we're talking...there's the gas folks are in the same situation. Don't make any difference if you're talking about oil or gas. More money is more money to operate those...those marginal wells, at best, up there. We've got one guy up there who has, I was told, has 56 wells up there. And four of those wells are all that's keeping the other 52 going, because he's getting so little out of those...the rest of them that they're just not worth doing unless he has those four wells. And those are the kind of things that are...that are going to happen...those other 52 wells are...in pretty serious jeopardy, and that's just a pittance compared to the total of them. But that's where my folks are, up in my country. They said, "we can't...we're not willing to have you support anything that will go any higher and we'd rather have you propose that we go back to net proceeds in the 1991 session than go up...than put any more tax burden on us under your flat tax system". And I said, "that's fine with me. I don't like it, but you're the folks I'm representing up here and I'll be guided by your wishes". And that's where I'm at at the present time.

Two voice both say, "let's eat".

Senator Gage:

Okay, we go back in at 1:00 p.m in the Senate. House goes back in..?

Representative Schye:

At 1:00 p.m.

Senator Gage:

At 1:00 p.m.? With probably nothing on the agenda?

Some unclear comments between the Representatives regarding whether there is a report on the agenda.

Representative Schye:

We'll be back here at 1:15 p.m.

Senator Gage:

We'll adjourn, then, until 1:15 p.m.

Senator Gage reconvenes the meeting at 2:00 p.m.

Senator Gage:

We'll call our hearing back to order again. I guess I'm not...I don't know where we're at at this point. If anybody has a comment, proposal, direction, or whatever, you have the floor.

Representative Schye:

Excuse me a minute while I get all the popcorn out of my teeth...maybe that's why you gave it to us. Is that it?

Senator Crippen:

That bag is supposed to stick, someway or another.

Representative Schye:

I hope you didn't get..(unclear..

Well, Senator Gage and Senator Crippen...

Senator Crippen:

And Representative Ramirez...(laughter)...I mean, Patterson...

Representative Schye:

No, I consider Representative Patterson part of us. He is from the House. He's in the good body.

Senator Gage:

You need to address Senator Mazurek, then.

Representative Schye:

You had mentioned to me that you and I both sit on the Revenue Oversight. I guess I am willing to take you for your word that this will be studied...the conversions from...from what we talked about. Now, there is language in the bill, now, that directs the

Department of Revenue to study the rates, or the Revenue Oversight to study the rates. That's all in there still...that hasn't been amended out.

Lee Heiman:

That hasn't. That hasn't.

Representative Schye:

The study process. Both you and I are on that Committee along with Representative Patterson and Senator Gage and the whole works.

Senator Gage:

Not me.

Representative Schye:

Senator Mazurek.

Senator Crippen:

Oh, that's right...you're not on that...sorry.

Representative Schye:

Okay, there's four of us that are on that Committee. That we will make an effort...not make an effort...we will study that very carefully, the whole thing that's in the study resolution on the rates, on the royalties from working to non-working, and have a report ready. Also, I would like to have the Department of Revenue to do that and have a report ready for the Legislature of how many people have converted from working to non-working at the next Legislature -- (he corrects himself) non-working to working. And..do that. And I guess I would like a commitment from you that if there are problems with that, we see the problems in the Revenue Oversight, we see the problems from the Department of Revenue, that you and I will co-sponsor legislation to change those problems.

Senator Crippen:

(Laughter). I must have got the sticky bag.

Well, I'll tell you what I'll do, I'm not going to say that I'll co-sponsor anything with you, Representative Schye. Of course, that would be looking down the line as to where we would be, we may not agree. But as far as the Revenue Oversight Committee is concerned, most certainly, I'd even go one step further and I would request that the next time we're in there that we would request a time and place for a hearing after the Department of Revenue has had the opportunity to come up with the figures. You know, I would imagine that could be in the fall or sometime even in late summer and have the hearing...so we could even go one step further. And we could get all that information then.

Representative Schye:

Now, I want to make sure we've got this real clear. I want to...I want to hear on stripper gas, you know, not just...everything that we can get on the stuff we've tried to get through in the special session in this bill in that hearing...or in there. Even if we have to, someway, wrangle more money out of the Legislative Council, or wherever our budgets are or whatever they are. Have more meetings or whatever it is.

Senator Crippen:

That's fine.

Representative Schye:

Okay, we...we will...

Senator Crippen:

Except for the sponsorship, other than that...yeah...

Representative Schye:

Well, I just kind of threw that out to see...

Laughter.

...to see if, possibly, that...that could happen...we kind of thought that might not be..be the case. But, I think you and I could probably agree on something, sometime, down the road.

Senator Crippen:

Yup.

Representative Schye:

Okay.

Senator Gage:

I might interject, here, Representative Schye, a month or six weeks ago, the Department of Revenue and I agreed that we would...we would track that in their natural resource tax department, and if we saw something happening, we would know we would have to address that in the legislative session. So, to my understanding, at least, that tracking process is already happening with the Department of Revenue.

Representative Schye:

Well, we would..we would like to see that, you know, down someplace, whether in the bill, or whatever, but that the Department of Revenue does report to the legislators on that, because there are...there are a lot of feelings that we have pretty strong about that and just as strong as the feelings are..yours...the other way.

Senator Crippen:

That's fine, and as I said, we've got to think of...one step further and hold a hearing so we know. Everybody has an opportunity to present evidence. And if we find that if,in fact, there is a problem, then I think we'd be willing to take a good look at it and, perhaps, even go so far as to cosponsor something. You never know, keep your hopes up.

Representative Schye:

My hopes are always up with you, Senator - that we can agree on some tax policy. There's one we probably will not -- someday, maybe --- you will agree with me.

Laughter.

All right. Now, going back from there to the rates. Now, we always understand, in special sessions, that things go fast and things are sometimes...lots of information that's put out. We can't all agree and disa...well, we can't all agree on it. Some of it comes from the industry, some of it comes from our taxpayers at home, and so on. I hope this study will give lots of information for the legislature in the future to deal with this process. Now, we're willing to stay with your last offer on the gas - not agreeing - I'm not sure I agree with that. Our..our caucus agrees with that. But we're willing to go with that... with that offer that you put out last on...on the gas.

Now, we had already agreed on the oil. We will go with the gas, with the study, to make sure they're right. Now like I said, there's not...not total agreement in our caucuses on that. What's going to happen on the floor, I don't know. We will go with that. I want to learn a lot more on it. I'm going to really work hard on my own, to get as much information of this as I can. I might even go up and stay with Senator Gage so he can take me around to some of those stripper gas wells. You don't have any down in your area (directed to Senator Crippen).

Senator Crippen:

We don't know a great deal about gas down there.

Representative Schye:

I won't come back with what I thought...

Laughter.

I felt...I felt that we, as Democrats, and the House, came in with good proposals. We had legitimate numbers. I still feel uncomfortable with the numbers we have in the legislation. But, I think that we can sign the conference committee. We will go from there.

Senator Crippen:

I guess, Mr. Chairman, I think that's fine and I think we're making some progress. I guess the one concern that I have is that - can you give me an indication of what type of authority that you have..going back to your caucuses? Is this, you know, from what I understand what you're telling me, you don't have authority, really, to negotiate.

Representative Schye:

I guess I don't understand the question. What do you mean...I have authority to negotiate.

Senator Crippen:

Well..I mean..you have no..help, you know..I was..you're going to take this back and make a good faith effort in your caucus to see that it's...

Representative Schye:

Yes, I will, but I don't have...I don't have total agreement. I will vote for the...for the bill on the floor. I will speak for the bill...or the amendment on the floor. But I can't...I'm not going to say that our caucus is 100% behind it, because it's not.

Senator Crippen:

Okay.

Senator Gage:

Okay, Representative Schye, then, so we're... so we all understand where we're at...We're at 15.25% on regular gas, 15.25% on royalty gas, and 10% on stripper gas. That's your understanding?

Representative Schye:

It's..it's right off..right off the sheet that you handed us this morning.

Senator Mazurek:

15.25%, 10% on stripper, 15.25% on all royalty (last word unclear)

Senator Gage:

Okay, and oil at 8.4% on regular, 5% on stripper, and 12.5% on royalty.

Representative Schye:

Right.

Senator Gage:

Okay.

Representative Schye:

Now, I guess, Senator, I'll ask the same thing. Do you have 100% vote in your caucus.

Senator Crippen:

I don't have 100% but I think I've got authority to negotiate.

Representative Schye:

Well, Senator, I had authority to negotiate.

Senator Crippen:

What..okay. Well, that's all I wanted to hear, because..(both talking at once)...on your bets....

Representative Schye:

No, no...I have...I have authority to negotiate as long...all of us have. We all negotiated in good faith and we are...our caucuses put a lot of faith in us.

Senator Crippen:

All right.

Senator Gage:

Okay, further proposals from anyone...comments?

Senator Mazurek:

Mr. Chairman.

Senator Gage:

Senator Mazurek.

Senator Mazurek:

I want to get back to the Department of Revenue information...(unclear - no microphone)

A lot of mumbling...

Unidentified Committee Member:

I was just winking at Senator Crippen.

Laughter.

Senator Gage:

Okay, Senator Mazurek.

Senator Mazurek:

I wasn't clear...are we going to put an amendment in the bill that would require the Department of Revenue to report on conversions between operating..royalty interests for the next session, or are you just asking them to do that? What...

Senator Gage:

That's in the bill, now, as I understand it?

Several: "no...no, it's not"

Representative Schye:

No, it is not in the bill, but I would like that provision to be in the bill.

Senator Mazurek:

For the next session only? Is that..

Senator Crippen:

To make a report to them..

Representative Schye:

Make a report to the next session, possibly, we could go on.

Senator Gage:

Do we need to...maybe, a question for Lee. Do we need to put anything about that section sunsetting, Lee, or anything of that nature?

Lee Heiman:

Mr. Chairman, no. Now, we have the provision for Revenue Oversight. Are we talking, now, about adding a provision for the Department of Revenue, over there, too, to report to the Revenue Oversight Committee?

Senator Mazurek:

No, to the leg..to the next legislature.

Representative Schye:

To the next legislature. We would...I would rather...I would like to have it for more that one legislature, though. If we could go for a biennium...past...to see if there's conversion...six months...there isn't a whole lot of time from now until the next legislature. Then we can go again, in the next legislature...let's see, we've got the '91..report to the '91 and the '93 legislature.

Senator Gage:

Okay, would someone like to make a motion to that effect and let Lee work out the language..or do you have language available..or..

Representative Schye:

No, I don't have language available, Senator. I would make that motion.

Senator Gage:

Okay, we have a motion to include the study by the Revenue Oversight Committee and, also, a requirement that the Department of Revenue report to the 1991 and 1193 Legislatures.

Senator Mazurek:

That's only limited to, at least in terms of formal reporting, to changes between working or operator and royalty. That's all..it's fairly narrow.

Senator Gage:

Yes. Got enough, Lee, for..to do what you need?

(Lee indicated yes.)

Okay, everyone understand the motion?

Ready for the question?

Those in favor of the motion - the Senators - indicate by saying "aye".

Unanimous.

Opposed, if any.

(None.)

House members in favor of the motion indicate by saying "aye".

Unanimous.

Opposed, if any.

(None.)

The motion passes.

Senator Gage continues...

Anything else that you would like to discuss at the conference?

Senator Mazurek:

Could we recap where we are? We've got this...we've got this...and I don't mean in so much as rates, we've done that. But we've also eliminated the (unclear - sounds like "leading") mistake on severance and....

Senator Gage:

This is kind of a grey bill..Lee..type thing?

(Lee Heiman passed out the reference reading copy of amendments to SB 1 (attachment #7).)

Lee Heiman:

Well, this would be the committee report, except for the Kadas amendment on the last page, as a substitute bill showing..so that you can look at it and read it. I put line numbers along the edges - the line numbers that are circled have the rates in it. It's exactly where..where we're standing right now. This has everything in the bill as it came out of the Senate. What amendments you made in the Senate are incorporated in this.

Senator Crippen:

Has the LFA and the DOR had a chance to look at this?

Lee Heiman:

The LFA has.

Senator Crippen:

How about the DOR? Mr. Adams, have you had an opportunity to check this out?

Dennis Adams, Director, Department of Revenue:

No, we have not at this time.

Senator Gage:

Something that was brought up, I guess, let's see, Jeff (Martin - Legislative Council) brought it up, I think, and maybe the Department of Revenue might have a concern about it, Dennis. Jeff brought up the fact that where we have put total gross taxable value...he felt that it made sense to leave "taxable" out of there. He thought it did more to cloud the issue than it did to clarify. And I don't think it's a..it's a major issue because there's an indication in the bill later that the royalty is not subject to the non-working and the royalty interests both....would you comment? Go ahead. Do you think it makes sense, one way or the other, to have that in there or out of there?

Director Adams:

Mr. Chairman, Members of the Committee, so long...I'll check back and make sure that's adequately covered in another area, but our concern with going with "gross taxable value" rather than just "gross value" is that there are exempt royalties that are not subject to tax. That we cannot tax. One of the federal royalties, any royalties - state royalties - that are included in the gross value versus a gross taxable value. That our percentages only apply to the gross taxable value.

Senator Gage:

Yeah, and that's why I changed that language when I was going through the bill, originally, was that...that was my concern that if it said "gross value" there might be those...there might be those...and additionally so since the work...the operator on his resource indemnity trust tax, I understand, has to pay resource indemnity trust tax on his total production, whether there is exempt royalties or not. And I didn't check that out, but I assume some of the operators who I talked to have, and I got several letters that said, "why do we get to exempt those exempt royalties from other taxes, but we have to pay RIT tax on those exempt royalties?". And that's why I thought it made sense to put "taxable" in here. So that it was very clear that...that the operator wouldn't have to pay tax on those exempt royalties and not be able to recover it from the royalty owner.

Director Adams:

Mr. Chairman, that is correct. That is our concern, also.

Senator Gage:

Okay, thank you. Did...would anybody like to comm...I guess that's why that's in there as "taxable". That was my concern that they can recover...the operator can recover his severance tax and his conservation tax from the royalty owner, but for those exempt people, he cannot recover his RIT tax, even though it's exempt...even though that is exempt as far as those other taxes. The royalty owner must pay tax on that and has no one to recover it from. I think it's an oversight, my personal opinion is that it was an oversight, and makes sense to me that if they're exempt for state conservation and state severance, they should be exempt, also, for resource indemnity trust tax. But, I wanted to make sure that that didn't happen with regard to the local government severance tax. And that's why we're putting that in that way.

Any other comments anyone would have, or suggestions, or...

Senator Mazurek:

Just make sure our minutes reflect that, carefully, why we used the words "taxable"..

Senator Gage:

I would, I guess, just request that before we sign any of the minutes, I assume they will be done after we are gone home, that..

Jill Rohyans:

They will be verbatim minutes.

Senator Gage:

Yes, and as verbatim as we can get them, and that each of us look at them, and if you have any problem with them, I would ask you to contact me so that we can talk about problems that you might have with the language or with the minutes so that we can get them corrected to what all of us think what happened so that our records will reflect what all of us agree was meant and what all of us agree happened during this..these hearings. Other than that, if there is nothing further, we will take this...Oh yes, we need a motion to adopt a conference committee report.

Some unclear discussion as to whether the amendments were adopted follows:

Representative Schye:

Have we adopted your amendments?

Senator Crippen:

We haven't adopted...

Senator Gage:

We didn't vote on Bruce's motion...or did anybody make a motion?

Senator Mazurek:

Well, why doesn't somebody...Mr. Chairman?

Senator Gage:

Joe?

Senator Mazurek:

I move we adopted the amendments prepared by Lee Heiman (attachment # 7) with the exception of the last page which is the Kadas amendment, but..and that it also include the requirement that the Department of Revenue report in the 1991 - 1993 legislature - legislative sessions any shifts between working and non-working interests.

Senator Gage:

And that Revenue Oversight take a look at that?

Senator Mazurek:

Well, that's already in there.

Senator Gage:

Oh, that's in there? Okay.

Representative Schye:

Well, no, it's not in <u>here</u>..I..

Senator Mazurek:

It's in the bill now (everyone talks at once)..the language adopted by the House Taxation Committee, a new Section 5.

Senator Gage:

And the motion. Okay. Discussions on the motion?

Hearing none, Senate members in favor of the motion indicate by saying "aye".

Unanimous.

Any opposed?

(None.)

House members indicate...in favor of the motion, indicate by saying "aye".

Unanimous.

Any opposed?

(None.)

Voting is unanimous on the motion. These free conference committees, particularly, seem to be a little more difficult, because we generally end up in areas that we wouldn't end up with a conference committee. I don't think, probably, any of us, have heard the last of this whole thing from future sessions, yet. But, I appreciate all of your input. I don't think any of us have said anything that we are sorry we said to each other. And I don't think anybody said anything about each other that we're not proud of and I thank all of you for your efforts.

Jill Rohyans: Do we need to adopt the final report?

Senator Gage:

Oh yes, we need to adopt the conference committee report, then, I assume.

Senator Mazurek:

I move the committee report be adopted.

Senator Gage:

Okay. Senate members in favor of adopting the committee report indicate by saying "aye".

Unanimous.

Opposed, if any?

(None.)

House members in favor of adopting the committee report indicate by saying "aye".

Unanimous.

Opposed, if any?

(None.)

Voting is unanimous. Thank you.

ADJOURNMENT

Adjournment At: 2:45 p.m., May 25, 1990

SENATOR DELWYN GAGE, Chairman

DG/JDR

FCCSB1.524

Free Conference Committee Report
on Senate Bill 1
Report No. 1, May 25, 1990

Mr. President and Mr. Speaker:

We, your Free Conference Committee on Senate Bill 1 met and considered:

House Committee on Taxation's report of May 23, 1990 (green sheet) that amended Senate Bill 1 (reference copy -- salmon).

We recommend that Senate Bill 1 (reference copy -- salmon) be amended as follows:

[adopted May 25 at 14:30]

1. Title, line 8.
Following: "~~PRODUCTION;~~"
Insert: "GENERALLY"
Strike: "STATE AND"

2. Title, line 11.
Following: "~~PRODUCTION;~~"
Insert: "IMPOSING A REVENUE NEUTRAL LOCAL GOVERNMENT SEVERANCE TAX RATE ON NONWORKING INTEREST OWNERS OF OIL AND NATURAL GAS PRODUCTION;"

3. Title, line 20.
Following: "~~WELLS;~~"
Insert: "CLARIFYING THE APPLICATION OF THE LOCAL GOVERNMENT SEVERANCE TAX TO NATURAL GAS STRIPPER WELLS; CLARIFYING THE LOCAL GOVERNMENT SEVERANCE TAX ON OIL STRIPPER WELLS;"

4. Title, line 23.
Following: "PROVIDING"
Insert: "FOR"

5. Title, line 24.
Following: "COMMITTEE"
Insert: "AND FOR REPORTS TO THE LEGISLATURE BY THE DEPARTMENT OF REVENUE"

6. Pages 2 through 26.
Strike: everything following the enacting clause
Insert: "Section 1. Section 15-36-101, MCA, is amended to read:
"15-36-101. Definitions and rate of tax -- state

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severance tax -- local government severance tax -- assessment of nonworking interest owner -- exemption. (1) Every person engaging in or carrying on the business of producing petroleum, other mineral or crude oil, or natural gas within this state or engaging in or carrying on the business of owning, controlling, managing, leasing, or operating within this state any well or wells from which any merchantable or marketable petroleum, other mineral or crude oil, or natural gas is extracted or produced ~~sufficient in quantity to justify the marketing of the same must~~ shall, except as provided in 15-36-121, each year when engaged in or carrying on the business in this state pay to the department of revenue a state severance tax for the exclusive use and benefit of the state of Montana plus a local government severance tax in lieu of a tax on net proceeds for the exclusive use and benefit of local government. ~~The~~ Except as provided in subsection (3), the state severance tax and the local government severance tax are ~~computed at the following rates~~ as follows:

(a) except as provided in subsections (1)(b), (1)(c), ~~and~~ (1)(d), and (1)(e), a 5% ~~of~~ state severance tax on the total gross taxable value of all the petroleum and other mineral or crude oil produced by the person, plus the local government severance tax of 8.4% on ~~production~~ the gross taxable value of all the petroleum and other mineral or crude oil produced by the person other than interim production and new production, from each lease or unit; but in determining the amount of the state severance tax and local government severance tax, there must be excluded from consideration all petroleum or other crude or mineral oil produced and used by the person during the year in connection with his operations in prospecting for, developing, and producing the petroleum or crude or mineral oil;

(b) a 2.65% ~~of~~ state severance tax on the total gross taxable value of all natural gas produced by the person, plus the local government severance tax of 15.25% on the total gross taxable value of all natural gas ~~production~~ produced by the person other than interim production or new production, from each lease or unit; but in determining the amount of the state severance tax and the local government severance tax, there must be excluded from consideration all gas produced and used by the person during the year in connection with his operations in prospecting for, developing, and producing the gas or petroleum or crude or mineral oil; and there must also be excluded from consideration all gas, including carbon dioxide gas, recycled or reinjected into the ground;

(c) a 2.5% ~~of~~ state severance tax on the total gross taxable value of the incremental petroleum and other mineral or crude oil produced by the person, plus the local government severance tax of ~~4.2%~~ 5% on ~~production~~ the total gross taxable value of the incremental petroleum and other

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mineral or crude oil produced by the person other than interim production and new production, from each lease or unit in a tertiary recovery project after July 1, 1985. For purposes of this section, a tertiary recovery project must meet the following requirements:

(i) the project must be approved as a tertiary recovery project by the department of revenue. The approval may be extended only after notice and hearing in accordance with Title 2, chapter 4.

(ii) the property to be affected by the project must be adequately delineated according to the specifications required by the department; and

(iii) the project must involve the application of one or more tertiary recovery methods that can reasonably be expected to result in an increase, determined by the department to be significant in light of all the facts and circumstances, in the amount of crude oil which may potentially be recovered. For ~~the purpose~~ purposes of this section, tertiary recovery methods include but are not limited to:

(A) miscible fluid displacement;
(B) steam drive injection;
(C) micellar/emulsion flooding;
(D) in situ combustion;
(E) polymer augmented water flooding;
(F) cyclic steam injection;
(G) alkaline or caustic flooding;
(H) carbon dioxide water flooding;
(I) immiscible carbon dioxide displacement; or
(J) any other method approved by the department as a tertiary recovery method.

(d) except as provided in 15-36-121(2), a 3% ~~of~~ state severance tax on the total gross taxable value of all the petroleum and other mineral or crude oil ~~production~~ produced by the person after the first 5 barrels~~, plus the local government severance tax of 4.2% on all production other than interim production and new production, produced by~~ from a stripper well, as defined in 15-36-121, that produces more than 5 barrels a day during the period beginning April 1, 1989, and ending March 31, 1991~~.~~;

(e) a 5% local government severance tax on the total gross taxable value of all petroleum and other mineral or crude oil produced by the person other than interim and new production produced by a stripper well, as defined in 15-36-121.

(2) For purposes of this section, the term "incremental petroleum and other mineral or crude oil" means the amount of oil, as determined by the department of revenue, to be in excess of what would have been produced by primary and secondary methods. The determination arrived at by the department must be made only after notice and hearing and shall specify through the life of a tertiary project, calendar year by calendar year, the combined amount of

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primary and secondary production that must be used to establish the incremental production from each lease or unit in a tertiary recovery project.

(3) (a) A local government severance tax is imposed on the gross value paid in cash or apportioned in kind to a nonworking interest owner by the operator or producer of extracted marketable petroleum, other mineral or crude oil, or natural gas subject to local government severance taxes imposed under this chapter. The local government severance tax on nonworking interest owners is computed at the following rates:

(i) 12.5% on the gross value paid in cash or apportioned in kind to a nonworking interest owner by the operator or producer of extracted marketable petroleum and other mineral or crude oil;

(ii) 15.25% on the gross value paid in cash or apportioned in kind to a nonworking interest owner by the operator or producer of extracted or marketable natural gas.

(b) The amounts paid or apportioned in kind to nonworking interest owners are exempt from the local government severance taxes imposed under 15-36-121(3) and (4) and under subsections (1)(a) through (1)(e) of this section.

~~(3)~~(4) Nothing in this part may be construed as requiring laborers or employees hired or employed by any person to drill any oil or natural gas well or to work in or about any oil or natural gas well or prospect or explore for or do any work for the purpose of developing any petroleum, ~~or~~ other mineral or crude oil, or natural gas to pay the severance tax, nor may work done or the drilling of a well or wells for the purpose of prospecting or exploring for petroleum, ~~or~~ other mineral or crude ~~oils~~ oil, or natural gas or for the purpose of developing them be considered to be the engaging in or carrying on of the business. If, in the doing of any work, in the drilling of any oil or natural gas well, or in prospecting, exploring, or development work, any merchantable or marketable petroleum, ~~or~~ other mineral or crude oil, or natural gas in excess of the quantity required by the person for carrying on the operation is produced sufficient in quantity to justify the marketing of the petroleum, ~~or~~ other mineral or crude oil, or natural gas, the work, drilling, prospecting, exploring, or development work is considered to be the engaging in and carrying on of the business of producing petroleum, ~~or~~ other mineral or crude oil, or natural gas within this state within the meaning of this section.

~~(4)~~(5) Every person required to pay the state or local government severance tax under this section shall pay the tax in full for his own account and for the account of each of the other owner or owners of the gross proceeds in value or in kind of all the marketable petroleum or other mineral or crude oil or natural gas extracted and produced, including owner or owners of working interest, royalty

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interest, overriding royalty interest, carried working interest, net proceeds interest, production payments, and all other interest or interests owned or carved out of the total gross proceeds in value or in kind of the extracted marketable petroleum or other mineral or crude oil or natural gas, except that any of the interests that are owned by the federal, state, county, or municipal governments are exempt from taxation under this chapter. Unless otherwise provided in a contract or lease, the pro rata share of any royalty owner or owners will be deducted from any settlements under the lease or leases or division of proceeds orders or other contracts.

(6) For purposes of this section, the following definitions apply:

(a) "Gross taxable value" means the gross value of the product as determined in 15-36-103 less the gross value paid in cash or apportioned in kind to a nonworking interest owner by the operator or producer of extracted marketable petroleum, other mineral or crude oil, or natural gas.

(b) "Nonworking interest owner" means any interest owner who does not share in the development and operation costs of the lease or unit. (Subsection (1)(d) terminates on occurrence of contingency--sec. 7, Ch. 656, L. 1987.)"

Section 2. Section 15-36-112, MCA, is amended to read:

"15-36-112. Disposition of oil and gas state and local government severance taxes -- calculation of unit value for local government severance tax. (1) Each year the department of revenue shall determine the amount of tax collected under this chapter from within each ~~school district~~ taxing unit.

(2) For purposes of the distribution of local government severance taxes collected under ~~15-36-101~~ this chapter, the department shall determine the unit value of oil and gas for each ~~school district~~ taxing unit as follows:

(a) The unit value for petroleum and other mineral or crude oil for each ~~district~~ taxing unit is the quotient obtained by dividing the net proceeds taxes calculated on petroleum or mineral or crude oil produced in that ~~district~~ taxing unit in calendar year 1988 by the number of barrels of petroleum or other mineral or crude oil produced in that ~~district~~ taxing unit during 1988, excluding new and interim production.

(b) The unit value for natural gas is the quotient obtained by dividing the net proceeds taxes calculated on natural gas produced in that ~~district~~ taxing unit in calendar year 1988 by the number of cubic feet of natural gas produced in that ~~district~~ taxing unit during 1988, excluding new and interim production.

(3) The state and local government severance taxes collected under this chapter are allocated as follows:

(a) The local government severance tax is statutorily appropriated, as provided in 17-7-502, for allocation to the county for distribution as provided in subsection (4)~~(a)(ii)~~;

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(b) ~~Any amount not allocated to the county under subsection (3)(a)~~ The state severance tax is allocated to the state general fund.

(4) (a) For the purpose of distribution of the local government severance tax, the department shall adjust the unit value determined under this section according to the ratio that the local government severance taxes collected during the quarters to be distributed plus accumulated interest earned by the state and penalties and interest on delinquent local government severance taxes bears to the total liability for local government severance taxes for the quarters to be distributed. The taxes must be calculated and distributed as follows:

(i) By November 30 of each year, the department shall calculate and distribute to each eligible county the amount of local government severance tax, determined by multiplying unit value as adjusted in this subsection (4)(a) times the units of production on which the local government severance tax was owed during the calendar quarters ending March 31 and June 30 of the preceding calendar year.

(ii) By May 31 of each year, the department shall calculate and distribute to each eligible county the amount of local government severance tax, determined by multiplying unit value as adjusted in this subsection (4)(a) times the units of production on which the local government severance tax was owed during the 2 calendar quarters immediately following those quarters referred to in subsection (4)(a)(i).

(b) Any amount by which the total tax liability exceeds or is less than the total distributions determined in subsections (4)(a)(i) and (4)(a)(ii) must be calculated and distributed in the following manner:

(i) The excess amount or shortage must be divided by the total ~~units of production to obtain the tax value per unit of production~~ distribution determined for that period to obtain an excess or shortage percentage.

(ii) ~~The tax value per unit of production must be multiplied by the units of production in that taxable period in each school district that had production in that period, and this amount must be added to or subtracted from the distribution to each respective district~~ The excess percentage must be multiplied by the distribution to each taxing unit, and this amount must be added to the distribution to each respective taxing unit.

(iii) The shortage percentage must be multiplied by the distribution to each taxing unit, and this amount must be subtracted from the distribution to each respective taxing unit.

(5) The county treasurer shall distribute the money received under subsection ~~(3)(a)~~ (4) to the taxing ~~jurisdictions~~ units that levied mills in fiscal year 1990 against calendar year 1988 production ~~during fiscal year 1989~~ in the same manner that all other property tax proceeds

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were distributed during fiscal year ~~1989~~ 1990 in the taxing ~~jurisdiction~~ unit, except that no distribution may be made to a municipal taxing ~~jurisdiction~~ unit."

Section 3. Section 15-36-121, MCA, is amended to read:

"15-36-121. **Exemption from state severance tax -- imposition of local government severance tax.** (1) It is the public policy of this state to promote a sufficient supply of natural gas to provide for the residents of this state, to lessen Montana's dependence on imported natural gas, and to encourage the exploration for and development and production of natural gas, petroleum, and other mineral and crude oil within the state.

(2) All new production, as defined in 15-23-601, from a well during the 24 months immediately following the date of notification to the department of revenue that an oil well is flowing or being pumped or that a gas well has been connected to a gathering or distribution system is exempt from all of the state severance tax imposed by 15-36-101, provided the notification was made after March 31, 1987, and before July 1, 1991.

(3) All the natural gas produced from any well that has produced 60,000 cubic feet or less of natural gas a day for the calendar year prior to the current year shall be taxed as provided in this section. Production must be determined by dividing the amount of production from a lease or unitized area for the year prior to the current calendar year by the number of producing wells in the lease or unitized area and by dividing the resulting quotient by 365. The first 30,000 cubic feet of average daily production per well is exempt from all of the state severance tax imposed by 15-36-101. The first 30,000 cubic feet of average daily production per well is subject to a local government severance tax of 10%. Everything over 30,000 cubic feet of gas produced is taxed at 1.59% plus a local government severance tax of ~~7.625%~~ 10%.

(4) The first 5 barrels of average daily production from a stripper well are exempt from all of the state severance tax imposed by 15-36-101, ~~except~~ but not from the local government severance tax.

(5) For the purposes of this section, "stripper well" means a well that produces less than 10 barrels per day, determined by dividing the amount of production from a lease or unitized area for the year prior to the current calendar year by the number of producing wells in the lease or unitized area, and by dividing the resulting quotient by 365.

(6) Notwithstanding the provisions of subsections (2) through (4), all reporting requirements under the state severance tax remain in effect. (Subsections (2) and (4) terminate on occurrence of contingency--sec. 7, Ch. 656, L. 1987.)"

Section 4. Section 20-9-366, MCA, is amended to read:

"20-9-366. **(Effective July 1, 1990) Definitions.** As

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used in 20-9-366 through 20-9-369, the following definitions apply:

(1) "County mill value per elementary ANB" or "county mill value per high school ANB" means the sum of the current taxable valuation of all property in the county <u>plus the taxable value of oil and gas net proceeds determined under 15-23-607(4) for production occurring after March 31, 1990, plus the taxable value of coal gross proceeds determined under 15-23-703(3)</u> plus all the taxable value of ~~nontax~~ <u>nonlevy</u> revenue for the support of schools, other than Public Law 81-874 funds, <u>divided by 1,000, with the quotient divided by the total county elementary ANB count or the total county high school ANB count used to calculate the elementary school districts' and high school districts' current year foundation program amounts. The taxable value of nonlevy revenue</u> for the purpose of computing guaranteed tax base aid for schools is the amount of ~~nontax~~ <u>nonlevy</u> revenue received by a district in the previous year<u>, including for fiscal year 1991 the revenue received in fiscal year 1990 from the net proceeds taxation of oil and natural gas and including for fiscal year 1992 and thereafter the local government severance tax,</u> divided by the number of mills levied by the district in the previous year, multiplied by 1,000~~, divided by 1,000, with the quotient divided by the total county elementary ANB count or the total county high school ANB count used to calculate the elementary school districts' and high school districts' current year foundation program amounts~~.

(2) "District mill value per ANB" means the current taxable valuation of all property in the district <u>plus the taxable value of oil and gas net proceeds determined under 15-23-607(4) for production occurring after March 31, 1990, plus the taxable value of coal gross proceeds determined under 15-23-703(3)</u> plus all the taxable value of ~~nontax~~ <u>nonlevy</u> revenue for the support of schools, other than Public Law 81-874 funds, <u>divided by 1,000, with the quotient divided by the ANB count of the district used to calculate the district's current year foundation program schedule amount. The taxable value of nonlevy revenue</u> for the purpose of computing guaranteed tax base aid for schools is the amount of ~~nontax~~ <u>nonlevy</u> revenue received by a district in the previous year<u>, including for fiscal year 1991 the revenue received in fiscal year 1990 from the net proceeds taxation of oil and natural gas and including for fiscal year 1992 and thereafter the local government severance tax,</u> divided by the number of mills levied by the district in the previous year, multiplied by 1,000~~, divided by 1,000, with the quotient divided by the ANB count of the district used to calculate the district's current year foundation program schedule amount~~.

(3) "Guaranteed overschedule general fund budget" means that portion of a district's general fund budget in excess of the foundation program amount for the district, as

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provided in 20-9-316 through 20-9-321, but not exceeding 135% of the district's foundation program amount, and which excess is authorized under the provisions of 20-9-145 and 20-9-353.

(4) "Statewide mill value per elementary ANB" or "statewide mill value per high school ANB" means the sum of the current taxable valuation of all property in the state plus the taxable value of oil and gas net proceeds determined under 15-23-607(4) for production occurring after March 31, 1990, plus the taxable value of coal gross proceeds determined under 15-23-703(3) plus all the taxable value of ~~nontax~~ nonlevy revenue for the support of schools, other than Public Law 81-874 funds, divided by 1,000, with the quotient divided by the total state elementary ANB count or the total state high school ANB count used to calculate the elementary school districts' and high school districts' current year foundation program amounts. The taxable value of nonlevy revenue for the purpose of computing guaranteed tax base aid for schools is the amount of ~~nontax~~ nonlevy revenue received by a district in the previous year, including for fiscal year 1991 the revenue received in fiscal year 1990 from the net proceeds taxation of oil and natural gas and including for fiscal year 1992 and thereafter the local government severance tax, divided by the number of mills levied by the district in the previous year, multiplied by 1,000~~, divided by 1,000, with the quotient divided by the total state elementary ANB count or the total state high school ANB count used to calculate the elementary school districts' and high school districts' current year foundation program amounts~~."

NEW SECTION. Section 5. **Revenue oversight study -- reports by department of revenue.** (1) The revenue oversight committee shall study the new methods of taxing coal, oil, and natural gas production that were mandated by House Bill No. 28, Special Laws of June 1989, and amended by [this act]. The committee shall report its findings to the 52nd legislature.

(2) The department of revenue shall report to the 52nd legislature and to the 53rd legislature on any conversion of nonworking interest owner taxpayer status to operator taxpayer status.

NEW SECTION. Section 6. **Severability.** If a part of [this act] is invalid, all valid parts that are severable from the invalid part remain in effect. If a part of [this act] is invalid in one or more of its applications, the part remains in effect in all valid applications that are severable from the invalid applications.

NEW SECTION. Section 7. **Effective date.** [This act] is effective on passage and approval.

NEW SECTION. Section 8. **Retroactive applicability.** [Sections 1 and 3] apply retroactively, within the meaning of 1-2-109, to all local government severance taxes on oil and natural gas produced after December 31, 1988."

ADOPT

REJECT

And that this Conference Committee Report be adopted.

FOR THE SENATE	FOR THE HOUSE
Sen. Delwyn Gage, Chairman	Rep. Ted Schye, Chairman
Sen. Bruce Crippen	Rep. Mike Kadas
Sen. Joe Mazurek	John W Patterson Rep. John Patterson

ADOPT

REJECT

FCCsb01

5/25/90
4:00 p.m.

Free Conference Committee
on SB 1
Exhibit # 1
May 24-25, '90

STATE OF MONTANA

Office of the Legislative Fiscal Analyst

STATE CAPITOL
HELENA, MONTANA 59620
406/444-2986

TERESA OLCOTT COHEA
LEGISLATIVE FISCAL ANALYST

Morning of May 24, 1990.

Comparison of Local Government Severance Tax Bills and Definitions of "Revenue Neutral"

A. TAX RATES

Category	1987 Net Proceeds Average Effective Tax Rate	Current LGST	Gage - SB 1 As Introduced	Gage - SB 1 As Passed by the House	Gage - SB 1 As Passed by the Senate
OIL					
Operator					
Regular	7.32%	8.4%	8.11%	8.93%	8.4%
Stripper	8.22	4.2	4.06	8.93	4.2
Incremental	N/A	4.2	4.06	8.93	4.2
Royalty					
Regular	14.72	8.4	15.0	8.93	12.5
Stripper	14.72	4.2	15.0	8.93	12.5
NATURAL GAS					
Operator					
Regular	15.95	15.25	17.44	16.21	15.25
Stripper (exempt)	11.25	0.00	8.72	16.21	7.625
Stripper (taxable)	11.25	7.625	8.72	16.21	7.625
Royalty					
Regular	17.87	15.25	17.9	16.21	15.25
Stripper (exempt)	17.87	0.00	17.9	16.21	15.25
Stripper (taxable)	17.87	7.625	17.9	16.21	15.25
NEW & INTERIM PRODUCTION					
Oil	7.0	7.0	7.0	7.0	7.0
Gas	12.0	12.0	12.0	12.0	12.0

B. TAX REVENUE PRODUCED ON CALENDAR 1989 PRODUCTION (Millions)

	LGST Current	Gage - SB 1 As Introduced	Gage - SB 1 As Passed by the House	Gage - SB 1 As Passed by the Senate
LGST				
Oil	$22.4	$24.26	$25.55	$24.08
Natural Gas	5.3	8.76	10.35	7.62
Total	$27.7	$33.02	$35.90	$31.70
NEW AND INTERIM				
Oil	$ 2.09	$ 2.09	$ 2.09	$ 2.09
Natural Gas	1.33	1.33	1.33	1.33
Total	$ 3.42	$ 3.42	$ 3.42	$ 3.42
TOTAL	$31.12	$36.44	$39.32	$35.12

All bills are retroactive for calendar 1989 production on
*New rates will apply to calendar 1990 production (second

C. DEFINITIONS OF REVENUE NEUTRAL

	Net Proceeds Tax Liability (Millions)	Gross Value of Base (LGST Purposes) (Millions)
1) Tax on CY87 production/applied to CY87 tax base	$40.4	$437.27
2) Tax on CY87 production/applied to CY89 tax base	40.4	350.03
3) Tax on CY88 production/applied to CY89 tax base	35.9	350.03

	Tax on CY Production (Million)
4) New and interim production	
CY87	$ 1.54
CY88	2.19
CY89	3.42

D. TAX COLLECTION DATES

	Production Year	Tax Collected
1) Net proceeds and LGST	CY 1987	FY 1989
	CY 1988	FY 1990
	CY 1989	FY 1991
	CY 1990	FY 1992

	Production Year	Tax Collected
2) New and interim production tax	CY 1987	May 1987-Feb. 1988
	CY 1988	May 1988-Feb. 1989
	CY 1989	May 1989-Feb. 1990
	CY 1990	May 1990-Feb. 1991

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FREE CONFERENCE COMMITTEE
SB1 EXHIBIT #2
MAY 24-25, 1990

Amendments to Senate Bill No. 1
Reference Bill Copy

Requested by Sen. Gage
For the Free Conference Committee

Prepared by Jeff Martin
May 23, 1990

1. Title, lines 8 and 9.
Following: "~~PRODUCTION;~~"
Strike: remainder of line 8 through "RATES;" on line 9

2. Title, line 20.
Following: "~~WELLS;~~"
Insert: "CLARIFYING THE APPLICATION OF THE LOCAL GOVERNMENT SEVERANCE TAX TO NATURAL GAS STRIPPER WELLS;"

3. Title, lines 23 and 24.
Following: "BASE;"
Strike: the remainder of line 23 through "COMMITTEE;" on line 24

4. Title, line 25.
Strike: "15-36-101,"

5. Pages 2 through 26.
Strike: everything following the enacting clause
Insert: "Section 1. Section 15-36-112, MCA, is amended to read:

"**15-36-112. Disposition of oil and gas** state and local government **severance taxes -- calculation of** unit value for local government **severance tax.** (1) Each year the department of revenue shall determine the amount of tax collected under this chapter from within each ~~school district~~ taxing unit.

(2) For purposes of the distribution of local government severance taxes collected under ~~15-36-101~~ this chapter, the department shall determine the unit value of oil and gas for each ~~school district~~ taxing unit as follows:

(a) The unit value for petroleum and other mineral or crude oil for each ~~district~~ taxing unit is the quotient obtained by dividing the net proceeds taxes calculated on petroleum or mineral or crude oil produced in that ~~district~~ taxing unit in calendar year 1988 by the number of barrels of petroleum or other mineral or crude oil produced in that ~~district~~ taxing unit during 1988, excluding new and interim production.

(b) The unit value for natural gas is the quotient obtained by dividing the net proceeds taxes calculated on natural gas produced in that ~~district~~ taxing unit in calendar year 1988 by the number of cubic feet of natural gas produced in that ~~district~~ taxing unit during 1988, excluding new and interim production.

(3) The state and local government severance taxes collected under this chapter are allocated as follows:

(a) The local government severance tax is statutorily appropriated, as provided in 17-7-502, for allocation to the county for distribution as provided in subsection (4)~~(a)(ii)~~;

(b) ~~Any amount not allocated to the county under subsection~~

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~~(3)(a)~~ The state severance tax is allocated to the state general fund.

(4) (a) For the purpose of distribution of the local government severance tax, the department shall adjust the unit value determined under this section according to the ratio that the local government severance taxes collected during the quarters to be distributed plus accumulated interest earned by the state and penalties and interest on delinquent local government severance taxes bears to the total liability for local government severance taxes for the quarters to be distributed. The taxes must be calculated and distributed as follows:

(i) By November 30 of each year, the department shall calculate and distribute to each eligible county the amount of local government severance tax, determined by multiplying unit value as adjusted in this subsection (4)(a) times the units of production on which the local government severance tax was owed during the calendar quarters ending March 31 and June 30 of the preceding calendar year.

(ii) By May 31 of each year, the department shall calculate and distribute to each eligible county the amount of local government severance tax, determined by multiplying unit value as adjusted in this subsection (4)(a) times the units of production on which the local government severance tax was owed during the 2 calendar quarters immediately following those quarters referred to in subsection (4)(a)(i).

(b) Any amount by which the total tax liability exceeds or is less than the total distributions determined in subsections (4)(a)(i) and (4)(a)(ii) must be calculated and distributed in the following manner:

(i) The excess amount or shortage must be divided by the total ~~units of production to obtain the tax value per unit of production~~ distribution determined for that period to obtain an excess or shortage percentage.

(ii) ~~The tax value per unit of production must be multiplied by the units of production in that taxable period in each school district that had production in that period, and this amount must be added to or subtracted from the distribution to each respective district~~ The excess percentage must be multiplied by the distribution to each taxing unit, and this amount must be added to the distribution to each respective taxing unit.

(iii) The shortage percentage must be multiplied by the distribution to each taxing unit, and this amount must be subtracted from the distribution to each respective taxing unit.

(5) The county treasurer shall distribute the money received under subsection ~~(3)(a)~~ (4) to the taxing ~~jurisdictions~~ units that levied mills in fiscal year 1990 against calendar year 1988 production ~~during fiscal year 1989~~ in the same manner that all other property tax proceeds were distributed during fiscal year ~~1989~~ 1990 in the taxing ~~jurisdiction~~ unit, except that no distribution may be made to a municipal taxing ~~jurisdiction~~ unit."

Section 2. Section 15-36-121, MCA, is amended to read:

"**15-36-121. Exemption from state severance tax -- imposition of local government severance tax.** (1) It is the

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public policy of this state to promote a sufficient supply of natural gas to provide for the residents of this state, to lessen Montana's dependence on imported natural gas, and to encourage the exploration for and development and production of natural gas, petroleum, and other mineral and crude oil within the state.

(2) All new production, as defined in 15-23-601, from a well during the 24 months immediately following the date of notification to the department of revenue that an oil well is flowing or being pumped or that a gas well has been connected to a gathering or distribution system is exempt from all of the state severance tax imposed by 15-36-101, provided the notification was made after March 31, 1987, and before July 1, 1991.

(3) All the natural gas produced from any well that has produced 60,000 cubic feet or less of natural gas a day for the calendar year prior to the current year shall be taxed as provided in this section. Production must be determined by dividing the amount of production from a lease or unitized area for the year prior to the current calendar year by the number of producing wells in the lease or unitized area and by dividing the resulting quotient by 365. The first 30,000 cubic feet of average daily production per well is exempt from all of the state severance tax imposed by 15-36-101. The first 30,000 cubic feet of average daily production per well is subject to a local government severance tax of 7.625%. Everything over 30,000 cubic feet of gas produced is taxed at 1.59% plus a local government severance tax of 7.625%.

(4) The first 5 barrels of average daily production from a stripper well are exempt from all of the state severance tax imposed by 15-36-101, ~~except~~ but not from the local government severance tax.

(5) For the purposes of this section, "stripper well" means a well that produces less than 10 barrels per day, determined by dividing the amount of production from a lease or unitized area for the year prior to the current calendar year by the number of producing wells in the lease or unitized area, and by dividing the resulting quotient by 365.

(6) Notwithstanding the provisions of subsections (2) through (4), all reporting requirements under the state severance tax remain in effect. (Subsections (2) and (4) terminate on occurrence of contingency--sec. 7, Ch. 656, L. 1987.)"

Section 3. Section 20-9-366, MCA, is amended to read:

"**20-9-366. (Effective July 1, 1990) Definitions.** As used in 20-9-366 through 20-9-369, the following definitions apply:

(1) "County mill value per elementary ANB" or "county mill value per high school ANB" means the sum of the current taxable valuation of all property in the county plus the taxable value of oil and gas net proceeds determined under 15-23-607(4) for production occurring after March 31, 1990, plus the taxable value of coal gross proceeds determined under 15-23-703(3) plus all the taxable value of ~~nontax~~ nonlevy revenue for the support of schools, other than Public Law 81-874 funds, divided by 1,000, with the quotient divided by the total county elementary ANB count or the total county high school ANB count used to calculate

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the elementary school districts' and high school districts' current year foundation program amounts. The taxable value of nonlevy revenue for the purpose of computing guaranteed tax base aid for schools is the amount of ~~nontax~~ nonlevy revenue received by a district in the previous year, including for fiscal year 1991 the revenue received in fiscal year 1990 from the net proceeds taxation of oil and natural gas and including for fiscal year 1992 and thereafter the local government severance tax, divided by the number of mills levied by the district in the previous year, multiplied by 1,000~~, divided by 1,000, with the quotient divided by the total county elementary ANB count or the total county high school ANB count used to calculate the elementary school districts' and high school districts' current year foundation program amounts~~.

(2) "District mill value per ANB" means the current taxable valuation of all property in the district plus the taxable value of oil and gas net proceeds determined under 15-23-607(4) for production occurring after March 31, 1990, plus the taxable value of coal gross proceeds determined under 15-23-703(3) plus all the taxable value of ~~nontax~~ nonlevy revenue for the support of schools, other than Public Law 81-874 funds, divided by 1,000, with the quotient divided by the ANB count of the district used to calculate the district's current year foundation program schedule amount. The taxable value of nonlevy revenue for the purpose of computing guaranteed tax base aid for schools is the amount of ~~nontax~~ nonlevy revenue received by a district in the previous year, including for fiscal year 1991 the revenue received in fiscal year 1990 from the net proceeds taxation of oil and natural gas and including for fiscal year 1992 and thereafter the local government severance tax, divided by the number of mills levied by the district in the previous year, multiplied by 1,000~~, divided by 1,000, with the quotient divided by the ANB count of the district used to calculate the district's current year foundation program schedule amount~~.

(3) "Guaranteed overschedule general fund budget" means that portion of a district's general fund budget in excess of the foundation program amount for the district, as provided in 20-9-316 through 20-9-321, but not exceeding 135% of the district's foundation program amount, and which excess is authorized under the provisions of 20-9-145 and 20-9-353.

(4) "Statewide mill value per elementary ANB" or "statewide mill value per high school ANB" means the sum of the current taxable valuation of all property in the state plus the taxable value of oil and gas net proceeds determined under 15-23-607(4) for production occurring after March 31, 1990, plus the taxable value of coal gross proceeds determined under 15-23-703(3) plus all the taxable value of ~~nontax~~ nonlevy revenue for the support of schools, other than Public Law 81-874 funds, divided by 1,000, with the quotient divided by the total state elementary ANB count or the total state high school ANB count used to calculate the elementary school districts' and high school districts' current year foundation program amounts. The taxable value of nonlevy revenue for the purpose of computing guaranteed tax base aid for schools is the amount of ~~nontax~~ nonlevy revenue received by a district in the previous year, including for fiscal year 1991 the

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revenue received in fiscal year 1990 from the net proceeds taxation of oil and natural gas and including for fiscal year 1992 and thereafter the local government severance tax, divided by the number of mills levied by the district in the previous year, multiplied by 1,000~~, divided by 1,000, with the quotient divided by the total state elementary ANB count or the total state high school ANB count used to calculate the elementary school districts' and high school districts' current year foundation program amounts~~."

NEW SECTION. Section 4. **Severability.** If a part of [this act] is invalid, all valid parts that are severable from the invalid part remain in effect. If a part of [this act] is invalid in one or more of its applications, the part remains in effect in all valid applications that are severable from the invalid applications.

NEW SECTION. Section 5. **Effective date.** [This act] is effective on passage and approval.

NEW SECTION. Section 6. **Retroactive applicability.** [Section 2] applies retroactively, within the meaning of 1-2-109, to all local government severance taxes on natural gas produced after December 31, 1988."

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EX. # 3
MAY 24-25, 1990

MAY 23, 1990
89STRIP-JL

1989 PRODUCTION
LEASES WHICH HAD STRIPPER PRODUCTION

COUNTY	GAS STRIPPERS	OIL STRIPPERS	TOTAL STRIPPERS
***********	***********	***********	***********
BIG HORN	0	13	13
BLAINE	60	6	66
CARBON	7	8	15
CARTER	-	-	-
CHOUTEAU	33	0	33
CUSTER	6	0	6
DANIELS	0	1	1
DAWSON	0	3	3
FALLON	46	3	49
FERGUS	-	-	-
GARFIELD	0	2	2
GLACIER	109	59	168
GOLDEN VALLEY	1	1	2
HILL	34	3	37
LIBERTY	126	41	167
MCCONE	0	6	6
MUSSELSHELL	0	29	29
PETROLEUM	0	6	6
PHILLIPS	129	0	129
PONDERA	45	64	109
POWDER RIVER	0	2	2
PRAIRIE	1	0	1
RICHLAND	72	53	125
ROOSEVELT	14	16	30
ROSEBUD	0	13	13
SHERIDAN	29	8	37
STILLWATER	25	0	25
TETON	1	45	46
TOOLE	339	249	588
VALLEY	37	5	42
WIBAUX	1	0	1
YELLOWSTONE	0	9	9
	***********	***********	***********
	1,115	645	1,760

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1987 PRODUCTION
COMPARISON OF NET PROCEEDS TAXES TO OPTION 8

TAX REVENUE

Fiscal 1989 Oil and Gas Net Proceeds Tax	$40,384,725
Fiscal 1989 Local Gov. Sev. Tax - OPTION 8	$42,209,861
	************
	$1,825,136

Taxpayer		DIFFERENCE
************		************
Royalty Owners-	Stripper Gas Rate	$38,577
	Stripper Oil Rate	($407,533)
	Regular Gas Rate	($80,382)
	Regular Oil Rate	($2,344,553)
		************
		($2,793,891)
Operators -	Stripper Gas Rate	$1,284,773
	Stripper Oil Rate	($465,781)
	Regular Gas Rate	$534,411
	Regular Oil Rate	$3,265,624
		************
		$4,619,027
		$1,825,136

FREE CONFERENCE
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EX. #5
MAY 24-25, 1990

Amendments to Senate Bill No. 1
Third Reading Copy

Requested by Representative Kadas
For the Committee on Taxation

Prepared by Lee Heiman
May 23, 1990

1. Page 14.
Following: line 18
Insert: "(c) Notwithstanding any agreements between the parties or transfers of ownership or other interests, a percentage distribution that was payment in cash or apportionment in kind to a nonworking interest owner prior to December 31, 1988, is presumed to continue to be such a distribution and the person to whom it is paid is subject to the local government severance tax imposed by this subsection (3). The presumption may be rebutted by clear and convincing evidence that the interest owner receiving the value shares in the development, operating costs, and other liabilities similar to the development, operating costs, and other liabilities of majority of the ownership interests in the operation."

FREE CONFERENCE
COMMITTEE - SB1
EX. #6
MAY 24-25, 1990

AY 24, 1990
OPTION 12

DEPARTMENT OF REVENUE
COMPARISON OF TAX REVENUE BY COUNTY
FOR PRE-1985 PRODUCTION

OIL RATES		
***********		
REGULAR NON-ROYALTY	8.40%	8.40%
STRIPPER NON-ROYALTY	4.20%	5.00%
REGULAR ROYALTY	12.50%	12.50%
STRIPPER ROYALTY	12.50%	12.50%

GAS RATES		
***********		
REGULAR NON-ROYALTY	15.25%	15.25%
STRIPPER NON-ROYALTY	7.625%	10.00%
REGULAR ROYALTY	15.25%	15.25%
STRIPPER ROYALTY	15.25%	15.25%

COUNTY	SB1 THIRD READING	OPTION 12 LGST TOTAL DISTRIBUTION	DIFFERENCE
	***********	***********	***********
BIG HORN	$28,225	$28,545	$320
BLAINE	$1,904,755	$2,056,191	$151,436
CARBON	$1,292,546	$1,323,698	$31,152
CARTER	$0	$0	$0
CHOUTEAU	$189,376	$205,501	$16,125
CUSTER	$43,355	$47,047	$3,692
DANIELS	$0	$0	$0
DAWSON	$509,376	$515,192	$5,816
FALLON	$6,757,379	$6,850,357	$92,977
FERGUS	$9,085	$9,858	$774
GARFIELD	$56,794	$57,438	$644
GLACIER	$2,314,879	$2,393,677	$78,797
GOLDEN VALLEY	$9,491	$10,259	$768
HILL	$1,521,272	$1,650,731	$129,460
LIBERTY	$642,537	$671,848	$29,310
MCCONE	$98,880	$100,002	$1,122
MUSSELSHELL	$946,573	$957,311	$10,738
PETROLEUM	$101,290	$102,439	$1,149
PHILLIPS	$1,449,940	$1,573,399	$123,459
PONDERA	$529,539	$539,378	$9,839
POWDER RIVER	$1,114,815	$1,127,462	$12,646
PRAIRIE	$48,644	$49,200	$555
RICHLAND	$3,504,052	$3,550,215	$46,163
ROOSEVELT	$2,373,080	$2,401,392	$28,312
ROSEBUD	$311,658	$315,194	$3,535
SHERIDAN	$2,875,876	$2,911,890	$36,014
STILLWATER	$88,930	$96,502	$7,572
TETON	$131,543	$133,113	$1,570
TOOLE	$1,431,982	$1,505,952	$73,970
VALLEY	$258,648	$271,144	$12,496
WIBAUX	$1,032,497	$1,044,779	$12,282
YELLOWSTONE	$70,106	$70,901	$795
	***********	***********	***********
	$31,647,127	$32,570,616	$923,489

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MAY 24, 1990
OP12-87C

1987 PRODUCTION
COMPARISON OF NET PROCEEDS TAXES TO PROPOSED

TAX REVENUE

Fiscal 1989 Oil and Gas Net Proceeds Tax	$40,384,725
Fiscal 1989 Local Gov. Sev. Tax - OPTION 12	$41,152,797
	************
	$768,072

Taxpayer		DIFFERENCE
************		************
Royalty Owners-	Stripper Gas Rate	($32,329)
	Stripper Oil Rate	($255,132)
	Regular Gas Rate	($199,172)
	Regular Oil Rate	($711,550)
		************
		($1,198,183)
Operators -	Stripper Gas Rate	($261,370)
	Stripper Oil Rate	($781,263)
	Regular Gas Rate	($256,736)
	Regular Oil Rate	$3,265,624
		************
		$1,966,255
		$768,072

FREE CONFERENCE COMMITTEE
SB1 EX. #7
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Amendments to Senate Bill No. 1
Reference Reading Copy

For the Free Conference Committee

Prepared by Lee Heiman
May 25, 1990

Version Incorporates:

Oil	Gas	
8.4	15.25	Operator
5	10	Stripper
12.5	15.25	Non-Operator

1. Title, line 8.
Following: "~~PRODUCTION;~~"
Insert: "GENERALLY"
Strike: "STATE AND"

2. Title, line 11.
Following: "~~PRODUCTION;~~"
Insert: "IMPOSING A REVENUE NEUTRAL LOCAL GOVERNMENT SEVERANCE TAX RATE ON NONWORKING INTEREST OWNERS OF OIL AND NATURAL GAS PRODUCTION;"

3. Title, line 20.
Following: "~~WELLS;~~"
Insert: "CLARIFYING THE APPLICATION OF THE LOCAL GOVERNMENT SEVERANCE TAX TO NATURAL GAS STRIPPER WELLS; CLARIFYING THE LOCAL GOVERNMENT SEVERANCE TAX ON OIL STRIPPER WELLS;"

4. Title, lines 23 and 24.
Strike: "PROVIDING" on line 23 through "COMMITTEE;" on line 24

5. Pages 2 through 26.
Strike: everything following the enacting clause
Insert: "Section 1. Section 15-36-101, mca, is amended to read:

"**15-36-101. Definitions and rate of tax** -- state severance tax -- **local government severance tax** -- assessment of nonworking interest owner -- exemption. (1) Every person engaging in or carrying on the business of producing petroleum, other mineral or crude oil, or natural gas within this state or engaging in or carrying on the business of owning, controlling, managing, leasing, or operating within this state any well or wells from which any merchantable or marketable petroleum, other mineral or crude oil, or natural gas is extracted or produced ~~sufficient in quantity to justify the marketing of the same must~~ shall, except as provided in 15-36-121, each year when engaged in or carrying on the business in this state pay to the department of revenue a state severance tax for the exclusive use and benefit of the state of Montana plus a local government severance tax in lieu of a tax on net

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proceeds for the exclusive use and benefit of local government. ~~The~~ Except as provided in subsection (3), the state severance tax and the local government severance tax are ~~computed at the following rates~~ as follows:

(a) except as provided in subsections (1)(b), (1)(c), ~~and~~ (1)(d), and (1)(e), a 5% ~~of~~ state severance tax on the total gross taxable value of all the petroleum and other mineral or crude oil produced by the person, plus the local government severance tax of 8.4% on ~~production~~ the gross taxable value of all the petroleum and other mineral or crude oil produced by the person other than interim production and new production, from each lease or unit; but in determining the amount of the state severance tax and local government severance tax, there must be excluded from consideration all petroleum or other crude or mineral oil produced and used by the person during the year in connection with his operations in prospecting for, developing, and producing the petroleum or crude or mineral oil;

(b) a 2.65% ~~of~~ state severance tax on the total gross taxable value of all natural gas produced by the person, plus the local government severance tax of 15.25% on the total gross taxable value of all natural gas ~~production~~ produced by the person other than interim production or new production, from each lease or unit; but in determining the amount of the state severance tax and the local government severance tax, there must be excluded from consideration all gas produced and used by the person during the year in connection with his operations in prospecting for, developing, and producing the gas or petroleum or crude or mineral oil; and there must also be excluded from consideration all gas, including carbon dioxide gas, recycled or reinjected into the ground;

(c) a 2.5% ~~of~~ state severance tax on the total gross taxable value of the incremental petroleum and other mineral or crude oil produced by the person, plus the local government severance tax of ~~4.2%~~ 5% on ~~production~~ the total gross taxable value of the incremental petroleum and other mineral or crude oil produced by the person other than interim production and new production, from each lease or unit in a tertiary recovery project after July 1, 1985. For purposes of this section, a tertiary recovery project must meet the following requirements:

(i) the project must be approved as a tertiary recovery project by the department of revenue. The approval may be extended only after notice and hearing in accordance with Title 2, chapter 4.

(ii) the property to be affected by the project must be adequately delineated according to the specifications required by the department; and

(iii) the project must involve the application of one or more tertiary recovery methods that can reasonably be expected to result in an increase, determined by the department to be significant in light of all the facts and circumstances, in the amount of crude oil which may

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potentially be recovered. For ~~the purpose~~ purposes of this section, tertiary recovery methods include but are not limited to:

(A) miscible fluid displacement;
(B) steam drive injection;
(C) micellar/emulsion flooding;
(D) in situ combustion;
(E) polymer augmented water flooding;
(F) cyclic steam injection;
(G) alkaline or caustic flooding;
(H) carbon dioxide water flooding;
(I) immiscible carbon dioxide displacement; or
(J) any other method approved by the department as a tertiary recovery method.

(d) except as provided in 15-36-121(2), a 3% ~~of~~ state severance tax on the total gross taxable value of all the petroleum and other mineral or crude oil ~~production~~ produced by the person after the first 5 barrels~~, plus the local government severance tax of 4.2% on all production other than interim production and new production, produced by~~ from a stripper well, as defined in 15-36-121, that produces more than 5 barrels a day during the period beginning April 1, 1989, and ending March 31, 1991~~.~~;

(e) a 5% local government severance tax on the total gross taxable value of all petroleum and other mineral or crude oil produced by the person other than interim and new production produced by a stripper well, as defined in 15-36-121.

(2) For purposes of this section, the term "incremental petroleum and other mineral or crude oil" means the amount of oil, as determined by the department of revenue, to be in excess of what would have been produced by primary and secondary methods. The determination arrived at by the department must be made only after notice and hearing and shall specify through the life of a tertiary project, calendar year by calendar year, the combined amount of primary and secondary production that must be used to establish the incremental production from each lease or unit in a tertiary recovery project.

(3) (a) A local government severance tax is imposed on the gross value paid in cash or apportioned in kind to a nonworking interest owner by the operator or producer of extracted marketable petroleum, other mineral or crude oil, or natural gas subject to local government severance taxes imposed under this chapter. The local government severance tax on nonworking interest owners is computed at the following rates:

(i) 12.5% on the gross value paid in cash or apportioned in kind to a nonworking interest owner by the operator or producer of extracted marketable petroleum and other mineral or crude oil;

(ii) 15.25% on the gross value paid in cash or apportioned in kind to a nonworking interest owner by the operator or producer of extracted or marketable natural gas.

(b) The amounts paid or apportioned in kind to

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nonworking interest owners are exempt from the local government severance taxes imposed under 15-36-121(3) and (4) and under subsections (1)(a) through (1)(e) of this section.

~~(3)~~(4) Nothing in this part may be construed as requiring laborers or employees hired or employed by any person to drill any oil or natural gas well or to work in or about any oil or natural gas well or prospect or explore for or do any work for the purpose of developing any petroleum, ~~or~~ other mineral or crude oil, or natural gas to pay the severance tax, nor may work done or the drilling of a well or wells for the purpose of prospecting or exploring for petroleum, ~~or~~ other mineral or crude ~~oils~~ oil, or natural gas or for the purpose of developing them be considered to be the engaging in or carrying on of the business. If, in the doing of any work, in the drilling of any oil or natural gas well, or in prospecting, exploring, or development work, any merchantable or marketable petroleum, ~~or~~ other mineral or crude oil, or natural gas in excess of the quantity required by the person for carrying on the operation is produced sufficient in quantity to justify the marketing of the petroleum, ~~or~~ other mineral or crude oil, or natural gas, the work, drilling, prospecting, exploring, or development work is considered to be the engaging in and carrying on of the business of producing petroleum, ~~or~~ other mineral or crude oil, or natural gas within this state within the meaning of this section.

~~(4)~~(5) Every person required to pay the state or local government severance tax under this section shall pay the tax in full for his own account and for the account of each of the other owner or owners of the gross proceeds in value or in kind of all the marketable petroleum or other mineral or crude oil or natural gas extracted and produced, including owner or owners of working interest, royalty interest, overriding royalty interest, carried working interest, net proceeds interest, production payments, and all other interest or interests owned or carved out of the total gross proceeds in value or in kind of the extracted marketable petroleum or other mineral or crude oil or natural gas, except that any of the interests that are owned by the federal, state, county, or municipal governments are exempt from taxation under this chapter. Unless otherwise provided in a contract or lease, the pro rata share of any royalty owner or owners will be deducted from any settlements under the lease or leases or division of proceeds orders or other contracts.

(6) For purposes of this section, the following definitions apply:

(a) "Gross taxable value" means the gross value of the product as determined in 15-36-103 less the gross value paid in cash or apportioned in kind to a nonworking interest owner by the operator or producer of extracted marketable petroleum, other mineral or crude oil, or natural gas.

(b) "Nonworking interest owner" means any interest owner who does not share in the development and operation

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costs of the lease or unit. (Subsection (1)(d) terminates on occurrence of contingency--sec. 7, Ch. 656, L. 1987.)"

Section 2. Section 15-36-112, MCA, is amended to read:

"**15-36-112. Disposition of oil and gas state and local government severance taxes -- calculation of unit value for local government severance tax.** (1) Each year the department of revenue shall determine the amount of tax collected under this chapter from within each ~~school district~~ taxing unit.

(2) For purposes of the distribution of local government severance taxes collected under ~~15-36-101~~ this chapter, the department shall determine the unit value of oil and gas for each ~~school district~~ taxing unit as follows:

(a) The unit value for petroleum and other mineral or crude oil for each ~~district~~ taxing unit is the quotient obtained by dividing the net proceeds taxes calculated on petroleum or mineral or crude oil produced in that ~~district~~ taxing unit in calendar year 1988 by the number of barrels of petroleum or other mineral or crude oil produced in that ~~district~~ taxing unit during 1988, excluding new and interim production.

(b) The unit value for natural gas is the quotient obtained by dividing the net proceeds taxes calculated on natural gas produced in that ~~district~~ taxing unit in calendar year 1988 by the number of cubic feet of natural gas produced in that ~~district~~ taxing unit during 1988, excluding new and interim production.

(3) The state and local government severance taxes collected under this chapter are allocated as follows:

(a) The local government severance tax is statutorily appropriated, as provided in 17-7-502, for allocation to the county for distribution as provided in subsection (4)~~(a)(ii)~~;

(b) ~~Any amount not allocated to the county under subsection (3)(a)~~ The state severance tax is allocated to the state general fund.

(4) (a) For the purpose of distribution of the local government severance tax, the department shall adjust the unit value determined under this section according to the ratio that the local government severance taxes collected during the quarters to be distributed plus accumulated interest earned by the state and penalties and interest on delinquent local government severance taxes bears to the total liability for local government severance taxes for the quarters to be distributed. The taxes must be calculated and distributed as follows:

(i) By November 30 of each year, the department shall calculate and distribute to each eligible county the amount of local government severance tax, determined by multiplying unit value as adjusted in this subsection (4)(a) times the units of production on which the local government severance tax was owed during the calendar quarters ending March 31 and June 30 of the preceding calendar year.

(ii) By May 31 of each year, the department shall calculate and distribute to each eligible county the amount of local government severance tax, determined by multiplying

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unit value as adjusted in this subsection (4)(a) times the units of production on which the local government severance tax was owed during the 2 calendar quarters immediately following those quarters referred to in subsection (4)(a)(i).

(b) Any amount by which the total tax liability exceeds or is less than the total distributions determined in subsections (4)(a)(i) and (4)(a)(ii) must be calculated and distributed in the following manner:

(i) The excess amount or shortage must be divided by the total ~~units of production to obtain the tax value per unit of production~~ distribution determined for that period to obtain an excess or shortage percentage.

(ii) ~~The tax value per unit of production must be multiplied by the units of production in that taxable period in each school district that had production in that period, and this amount must be added to or subtracted from the distribution to each respective district~~ The excess percentage must be multiplied by the distribution to each taxing unit, and this amount must be added to the distribution to each respective taxing unit.

(iii) The shortage percentage must be multiplied by the distribution to each taxing unit, and this amount must be subtracted from the distribution to each respective taxing unit.

(5) The county treasurer shall distribute the money received under subsection ~~(3)(a)~~ (4) to the taxing ~~jurisdictions~~ units that levied mills in fiscal year 1990 against calendar year 1988 production ~~during fiscal year 1989~~ in the same manner that all other property tax proceeds were distributed during fiscal year ~~1989~~ 1990 in the taxing ~~jurisdiction~~ unit, except that no distribution may be made to a municipal taxing ~~jurisdiction~~ unit."

Section 3. Section 15-36-121, MCA, is amended to read:

"15-36-121. Exemption from state severance tax -- imposition of local government severance tax. (1) It is the public policy of this state to promote a sufficient supply of natural gas to provide for the residents of this state, to lessen Montana's dependence on imported natural gas, and to encourage the exploration for and development and production of natural gas, petroleum, and other mineral and crude oil within the state.

(2) All new production, as defined in 15-23-601, from a well during the 24 months immediately following the date of notification to the department of revenue that an oil well is flowing or being pumped or that a gas well has been connected to a gathering or distribution system is exempt from all of the state severance tax imposed by 15-36-101, provided the notification was made after March 31, 1987, and before July 1, 1991.

(3) All the natural gas produced from any well that has produced 60,000 cubic feet or less of natural gas a day for the calendar year prior to the current year shall be taxed as provided in this section. Production must be determined by dividing the amount of production from a lease

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or unitized area for the year prior to the current calendar year by the number of producing wells in the lease or unitized area and by dividing the resulting quotient by 365. The first 30,000 cubic feet of average daily production per well is exempt from all of the state severance tax imposed by 15-36-101. The first 30,000 cubic feet of average daily production per well is subject to a local government severance tax of 10%. Everything over 30,000 cubic feet of gas produced is taxed at 1.59% plus a local government severance tax of ~~7.625%~~ 10%.

(4) The first 5 barrels of average daily production from a stripper well are exempt from all of the state severance tax imposed by 15-36-101, ~~except~~ but not from the local government severance tax.

(5) For the purposes of this section, "stripper well" means a well that produces less than 10 barrels per day, determined by dividing the amount of production from a lease or unitized area for the year prior to the current calendar year by the number of producing wells in the lease or unitized area, and by dividing the resulting quotient by 365.

(6) Notwithstanding the provisions of subsections (2) through (4), all reporting requirements under the state severance tax remain in effect. (Subsections (2) and (4) terminate on occurrence of contingency--sec. 7, Ch. 656, L. 1987.)"

Section 4. Section 20-9-366, MCA, is amended to read:

"20-9-366. (Effective July 1, 1990) Definitions. As used in 20-9-366 through 20-9-369, the following definitions apply:

(1) "County mill value per elementary ANB" or "county mill value per high school ANB" means the sum of the current taxable valuation of all property in the county plus the taxable value of oil and gas net proceeds determined under 15-23-607(4) for production occurring after March 31, 1990, plus the taxable value of coal gross proceeds determined under 15-23-703(3) plus all the taxable value of ~~nontax~~ nonlevy revenue for the support of schools, other than Public Law 81-874 funds, divided by 1,000, with the quotient divided by the total county elementary ANB count or the total county high school ANB count used to calculate the elementary school districts' and high school districts' current year foundation program amounts. The taxable value of nonlevy revenue for the purpose of computing guaranteed tax base aid for schools is the amount of ~~nontax~~ nonlevy revenue received by a district in the previous year, including for fiscal year 1991 the revenue received in fiscal year 1990 from the net proceeds taxation of oil and natural gas and including for fiscal year 1992 and thereafter the local government severance tax, divided by the number of mills levied by the district in the previous year, multiplied by 1,000~~, divided by 1,000, with the quotient divided by the total county elementary ANB count or the total county high school ANB count used to calculate the elementary school districts' and high school districts'~~

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~~current year foundation program amounts~~.

(2) "District mill value per ANB" means the current taxable valuation of all property in the district plus the taxable value of oil and gas net proceeds determined under 15-23-607(4) for production occurring after March 31, 1990, plus the taxable value of coal gross proceeds determined under 15-23-703(3) plus all the taxable value of ~~nontax~~ nonlevy revenue for the support of schools, other than Public Law 81-874 funds, divided by 1,000, with the quotient divided by the ANB count of the district used to calculate the district's current year foundation program schedule amount. The taxable value of nonlevy revenue for the purpose of computing guaranteed tax base aid for schools is the amount of ~~nontax~~ nonlevy revenue received by a district in the previous year, including for fiscal year 1991 the revenue received in fiscal year 1990 from the net proceeds taxation of oil and natural gas and including for fiscal year 1992 and thereafter the local government severance tax, divided by the number of mills levied by the district in the previous year, multiplied by 1,000~~, divided by 1,000, with the quotient divided by the ANB count of the district used to calculate the district's current year foundation program schedule amount~~.

(3) "Guaranteed overschedule general fund budget" means that portion of a district's general fund budget in excess of the foundation program amount for the district, as provided in 20-9-316 through 20-9-321, but not exceeding 135% of the district's foundation program amount, and which excess is authorized under the provisions of 20-9-145 and 20-9-353.

(4) "Statewide mill value per elementary ANB" or "statewide mill value per high school ANB" means the sum of the current taxable valuation of all property in the state plus the taxable value of oil and gas net proceeds determined under 15-23-607(4) for production occurring after March 31, 1990, plus the taxable value of coal gross proceeds determined under 15-23-703(3) plus all the taxable value of ~~nontax~~ nonlevy revenue for the support of schools, other than Public Law 81-874 funds, divided by 1,000, with the quotient divided by the total state elementary ANB count or the total state high school ANB count used to calculate the elementary school districts' and high school districts' current year foundation program amounts. The taxable value of nonlevy revenue for the purpose of computing guaranteed tax base aid for schools is the amount of ~~nontax~~ nonlevy revenue received by a district in the previous year, including for fiscal year 1991 the revenue received in fiscal year 1990 from the net proceeds taxation of oil and natural gas and including for fiscal year 1992 and thereafter the local government severance tax, divided by the number of mills levied by the district in the previous year, multiplied by 1,000~~, divided by 1,000, with the quotient divided by the total state elementary ANB count or the total state high school ANB count used to calculate the elementary school districts' and high school districts'~~

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~~current year foundation program amounts~~."

NEW SECTION. Section 5. **Severability.** If a part of [this act] is invalid, all valid parts that are severable from the invalid part remain in effect. If a part of [this act] is invalid in one or more of its applications, the part remains in effect in all valid applications that are severable from the invalid applications.

NEW SECTION. Section 6. **Effective date.** [This act] is effective on passage and approval.

NEW SECTION. Section 7. **Retroactive applicability.** [Sections 1 and 3] apply retroactively, within the meaning of 1-2-109, to all local government severance taxes on oil and natural gas produced after December 31, 1988."

-End-

Amendments to Senate Bill No. 1
Third Reading Copy

Requested by Representative Kadas
For the Conference Committee

Prepared by Lee Heiman
May 23, 1990
Revised May 25, 1990

1. Page 3 of substitute bill.
Following 15-36-101(3)(b)
Insert: "(c) Notwithstanding any agreements between the parties or transfers of ownership or other interests, a percentage distribution that was payment in cash or apportionment in kind to a nonworking interest owner prior to December 31, 1988, is presumed to continue to be such a distribution and the person to whom it is paid is subject to the local government severance tax imposed by this subsection (3). The presumption may be rebutted by clear and convincing evidence that the interest owner receiving the value shares in the development, operating costs, and other liabilities similar to the development, operating costs, and liabilities of a majority of the working interests in the operation."