October 26, 2020

Dr. Greg Upton
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Re: Mineral Revenues in Louisiana

Dr. Upton,

LMOGA certainly appreciates all the work LSU's Center for Energy Studies has done and continues to do to support the oil and gas industry in the State of Louisiana. We certainly look forward to our continued collaboration with LSU CES and supporting the soon-to-be-released issue of the Gulf Coast Energy Outlook.

In this spirit of collaboration, we have identified four primary areas of concern as it relates to the Mineral Revenues in Louisiana report. It is our hope that you would take these into account, particularly in presentations of the report when comparing Louisiana to other energy states.

1. <u>Comparison States Allow a Deduction of Marketing Costs</u> - Comparing the tax rate to Oklahoma and Texas is not an apples-to-apples comparison. Texas and Oklahoma allow for the deduction of marketing costs (includes gathering, processing, and transportation – GP&T – costs) before determining the value subject to severance tax.

   Because GP&T costs can be significant in relation to the revenue received for gas, allowing for the deduction for these costs, can drastically decrease the amount subject to tax.

   If producers received $0.70 to $1.50 per Mcf after subtracting marketing costs, the tax rate in Louisiana for FY20 would have been between 8.3% and 17.9% on a comparable basis with that of Oklahoma or Texas (price realized of $0.70 to $1.50 per mcf at a severance tax rate of $0.125).

   As you have mentioned previously, it is the tax burden, not the tax rate, that is the most relevant data point when comparing the tax structure of two (or more) states.

   Not allowing the deduction of GP&T costs greatly increases the severance tax burden on producers in Louisiana. In states like Texas and Oklahoma, GP&T costs can materially reduce the amount subject to tax (i.e., the proceeds actually realized by the producer). As a result, the disallowance of the deduction of GP&T costs could have a greater impact to the overall tax burden than an increase in tax rate.

2. <u>The 4% Rate is Overstated Without a Deduction for Marketing Costs</u>
   The per mcf rate is based on a statutory calculation that compares the prior year average price to $1.7446/MMBTU. For 4% to be the actual rate, gas (prior to marketing costs) would

have needed to be $3.125 per Mcf for FY20, yet gas has not traded over $3 for some time now, especially the in-basin pricing, which producers actually received and which would be subject to tax in Texas and Oklahoma.

Since producers were receiving less than the $3/MMBTU threshold, the effective tax rate is much higher than 4% because the amount of tax is fixed per Mcf. Some producers received less than $1 per Mcf after the deduction of marketing costs. In this case, the FY20 tax rate on a basis comparable to Oklahoma or Texas exceeded 12.5% for these producers.

3. Oil and Gas Reserves are Subject to Property Tax – Although the Constitution prohibits the direct taxation of reserves and below-ground equipment, the taxation of the cost to drill and equip a well effectively serves as a means of levying tax on the reserves and below-ground equipment. If it is not the reserves and the below-ground equipment being taxed, then a significant amount of tax is being assessed on what essentially is a hole in the ground.

   Presently, these property tax valuations do not decline as the wells production declines, which could put Louisiana assets at an increasing disadvantage as they age and their production naturally declines. As a result, the cumulative property tax over the life of a well would often be greater in Louisiana than it would have been in Texas for the same well.

4. The Sales Tax Rates in Louisiana are Higher than Surrounding States – Parish sales tax rates that are added to the state sales tax make the total sales tax rate in Louisiana 2-4% higher than comparison states/counties, as shown in the detailed comparison below.

   Louisiana – State Rate: 4.45%
   - De Soto Parish: 4% (8.45% total)
   - Sabine Parish: 4.63% (9.08% total)
   - Bossier Parish: 4.25% (8.7% total)
   - Natchitoches Parish: 5.5% (9.95% total)
   - Caddo Parish – 4.35% (8.8% total)

   Texas – State Rate: 6.25%
   - Reeves County (Permian): 0% (6.25% total)
   - Pecos County (Permian): 0% (6.25% total)
   - Midland County (Permian): 0.5% (6.75% total)
   - All Counties in Eagle Ford: 0.5% (6.75% total)

   Oklahoma – State Rate: 4.5%
   - Kingfisher County (STACK): 1.25% (5.75% total)
   - Stephens County (SCOOP): 0.7% (5.2% total)
   - Carter County (SCOOP): 0.88% (5.38% total)
   - Nobel County (Mississippi Lime): 1.5% (6% total)
   - Alfalfa County (Mississippi Lime): 2% (6.5% total)

Also, we are concerned about the potential ramifications of dissociating production taxes from product value in favor of a volume-based tax. This may work well for comparatively small taxes such as a mil levy, but it does not necessarily work well for larger taxes such as production or severance taxes.

Yes, an equivalent volume-based tax can be calculated to provide the same revenue as the value-based tax, but it is only correct at one point in time – the moment it is calculated. This can lead to issues if prices fluctuate between tax rate calculations.

Specifically, if gas prices drop, an operator would see its revenue drop, but not its tax burden. In extreme cases, the tax burden could exceed the revenue from the production until the next rate calculation takes place.

Finally, taking a higher-level view, from a Louisiana policy perspective, we are also concerned about the potential for rapid property and asset devaluations in gas-rich regions if gas severance taxes significantly increase over a short period of time.

Yes, there will be exemptions for existing wells, but because this will have potentially significant impacts on future revenue, property owners and leaseholders will realize impacts to the present value of their assets – assets in which companies and individuals invested using the current tax regime as the basis for their financial analysis.

The big picture concern would be an "overnight" devaluation of huge amounts of property in gas-rich areas, such as the Haynesville Shale.

In summary, we are concerned that the recommended increases in natural gas severance tax will cause harmful ripple effects throughout not just the natural gas production industry but large sections of the state.

Again, we certainly appreciate all that you and LSU CES do for the oil and natural gas industry in our state, and we look forward to continuing our collaborative relationship with you to promote this vitally important industry.

Sincerely,

Nathan McBride
Regulatory Affairs Manager
Louisiana Mid-Continent Oil and Gas Association