Tax Delinquencies and Budget Deficits:
A Case for Reform

A publication of the

Powder River Basin Resource Council

January 2018

POWDER RIVER BASIN
Resource Council

POWDER RIVER BASIN
Resource Council

934 N. Main St., Sheridan, WY 82801
(307) 672-5809
www.powderriverbasin.org

Who We Are

Founded in 1973, Powder River Basin Resource Council is a citizen-based organization of individuals and affiliate groups dedicated to the stewardship of Wyoming's natural resources. Through member empowerment, strategic alliances, and a dedicated staff, we work to preserve Wyoming's unique quality of life and our precious air, land, and water quality.

Our mission is to preserve and enrich our agricultural heritage and rural lifestyle; conserve Wyoming's unique land, minerals, water, and clean air consistent with the responsible use of these resources to sustain the livelihoods of present and future generations; and educate and empower Wyoming's citizens to raise a coherent voice to affect the decisions that will impact our environment and lifestyle.

We are a non-profit, 501(c)(3) tax-exempt organization.

Executive Summary

It is no secret that Wyoming is heavily dependent on mineral taxes to fund state and local government services. As a state, we get more than 70% of our total revenue from taxes on mineral extraction. This money funds essential services such as schools, first responders, and snow plowing. Mineral production downturns - busts - not only directly decrease state revenue but also present problems for collection of taxes owed to county governments. During the most recent downturn of mineral production in Wyoming, it became apparent that changes need to be made if Wyoming is to collect the full value of our mineral resources in the future. This report explores the extent of this growing problem and recommends some policy changes that could help counties continue to provide services during bust cycles.

Each county, of course, keeps detailed records on outstanding taxes, but no one has compiled that data on a state-wide level, until now. Our research shows that mineral companies owe a substantial amount - more than $42 million - in back taxes, penalties, and fees in twelve counties across the state.

While it may be difficult - if not impossible - for counties to collect these back taxes now because many companies are bankrupt or long gone, we can help to prevent a similar problem occurring in the future by making a few modest policy changes.

The need for reform will only grow as funding for education and government services declines. Because many county services are directly tied to income from mineral extraction, delinquent payments heavily impact individual county operating budgets. In addition, since much of the tax money collected by counties gets redistributed to all Wyoming school districts, delinquency also harms our statewide school system. Capital construction funding also comes from mineral extraction in the form of royalties and bonus bids. Since royalty funds shrink during production downturns, and fewer lease sales occur, school districts suffer a double impact to funding during lean years.

*At the state level, severance taxes (collected when minerals are severed from the ground) are collected on a regular, monthly basis, as minerals are produced. At the county level, however, "*ad valorem*" taxes (taxes on mineral production) are collected only annually, with an average lag time of around 18 months from the time of mineral extraction to tax collection. And a lot can happen in 18 months.*

During production boom years, counties fare well. When a bust cycle occurs, however, company bankruptcies can leave counties hit hardest of all. The lag time in collections means that when companies declare bankruptcy counties are left with debts that can be years old. Because the bankruptcy process is often lengthy and prioritizes some lenders over others, these debts are extremely difficult for counties to collect.

During bankruptcy proceedings, back taxes to counties are by law low priority in repayment. Counties are treated as unsecured lenders, and come in line behind private, secured lenders such as banks. If companies have more debt than they can pay off, debts to counties are left unpaid.

We propose the following solutions to give Wyoming and its counties the best opportunity to collect revenue owed to them when minerals are produced.

Recommendations:

1) **Counties should collect *ad valorem* mineral taxes on a monthly basis, similar to the way severance taxes are collected at the state level. (This change was proposed in a 2016 bill - HB64 - sponsored by the Joint Revenue Committee of the Wyoming Legislature.) During boom cycles, operators would be readily able to pay the taxes they owe. During bust cycles, counties would not be left with large-scale debts that are uncollectable.**

   BENEFIT: *If counties collect* ad valorem *taxes monthly, instead of annually, the amount of taxes left delinquent in the event of a bust or a bankruptcy will be dramatically reduced. Counties will benefit by having a smaller deficit, and companies will benefit by maintaining good standing with counties.*

2) **Counties should have continual and perpetual liens on *ad valorem* taxes. (This was proposed in the Wyoming legislature during 2017 in HB242.) This would place counties higher in the list for collections during bankruptcy proceedings because debt owed to them would be secured. With recommendation 1) in place, the secured debt companies owed to counties would be small enough that companies would be more likely to be able to pay in full during a bankruptcy proceeding.**

   BENEFIT: *If liens automatically attach to mineral production taxes owed to counties upon extraction, counties will be placed higher in the order of collections in bankruptcy proceedings. This will not ensure that counties will be able to recoup all debts owed to them, but it will make counties secured lenders and put them at the bargaining table with other secured lenders such as banks. When determinations are made on what debts will be paid fully or partially, counties will stand a better chance of collecting on at least some of the debts industries owe them.*

3) **A state funding pool should be established to assist counties during bankruptcy proceedings. Hiring specialized legal counsel experienced enough to represent a county in these complex and lengthy cases can be cost prohibitive to small counties, but it is critical that counties have the expertise to engage in the process and protect their interests. Having a fund held at the state level or allowing counties to access the Federal Natural Resource Policy Account, (an account managed by the state to fund state and local government involvement in matters of natural resource policy) would help counties pay legal fees and ensure that they have the means to secure effective representation.**

   BENEFIT: *Establishing a funding pool at the state level that counties can draw from when they need representation will help ensure that our poorest counties are able to collect taxes they desperately need for operations.*

4) **Legislation is needed to allow the Wyoming Oil and Gas Conservation Commission (WOGCC) and the Wyoming Department of Environmental Quality (WDEQ) to check the status of a company's state and county tax debt in Wyoming before allowing sale or transfer of assets. The WOGCC has regulations to ensure adequate bonding is in place prior to sale or transfer of wells from one operator to another,[7] and WDEQ has similar regulations for coal asset transfers, requiring licensing, bonding, and insurance of the new operator prior to transfer.[8] These agencies should also be able to check the tax status of companies to ensure that all debts to Wyoming and Wyoming counties are paid prior to transfer of assets.**

   BENEFIT: *If companies are barred from selling assets, changing lease ownership, or otherwise operating within Wyoming until they have paid all debts owed to the state and Wyoming counties, operators will have a strong incentive to pay their public debts as quickly as possible, and counties will have greater access to outstanding funds. Since* ad valorem *tax revenues are redistributed to all Wyoming schools, the state's public school districts will also benefit.*

Introduction:

The boom and bust cycle of energy production is very familiar to most Wyomingites. We rely heavily upon mineral production taxes to keep services running at state and local levels. Because basic services such as trash collection and road maintenance are dependent on mineral taxes, any disruption in collection has major impacts across the state that are felt immediately and have sustained effects on Wyoming's economy.

When prices are up, mineral extraction booms. We benefit from the influx of money, and funds around the state begin to fill. Money pours into local school districts. New programs are launched, and repairs are made. Snow plows keep roads clear in the winter, police officers patrol the streets, and life goes on as usual. When busts occur, the financial belt tightens and services are curtailed.

Minerals are commodities with global markets, and prices of oil, gas and coal are dictated by outside forces. Busts can come on very suddenly, leaving little time for Wyoming to prepare. Boom cycle spending must be reined in quickly. At the state and county level, budgets must be cut in all areas. School funds shrink rapidly. The number of offered programs may contract, schools may have to shut down and building and maintenance tasks are delayed.

Bust cycles are harmful to the whole state, but research presented in this report indicates counties are particularly hard hit. Most Wyoming counties operate on tight budgets normally, so shortfalls are felt immediately. To make matters worse, counties collect taxes long after they are accrued, unlike the state, which collects severance taxes on a monthly basis. Due to these differences, the state may be left with a few months of uncollectable back taxes, but counties can be owed years of delinquent tax debt.

When businesses fall on lean times, the public purse suffers a double whammy: fewer taxes are owed, and some previously assessed taxes are left unpaid. And when businesses seek the protection of bankruptcy laws, delinquent taxes are relegated to junior status and become even more difficult or impossible to collect. When this happens, our schools, roads and the other public services we rely upon cannot be paid for, and society suffers.

This report reveals the striking magnitude of mineral industry tax delinquencies in recent years, and suggests four simple changes in policy that could greatly reduce this problem.

Cumulative Debts Owed to Counties

During the past ten years, counties around Wyoming have experienced several bust cycles. The recent coalbed methane (CBM) and oil & gas downturn was particularly severe, leaving counties across the state with significant uncollected taxes. Some downturns affected many counties, and others impacted only a few. Regardless of the scale of individual busts, the cumulative impact has been substantial.

A bust can occur for oil, gas, coal, or any other extractable mineral resource. When a bust occurs for a given resource, counties with active extraction of that resource will be affected by loss of local jobs, loss of ongoing tax collection, and, in many cases, uncollectable taxes that were previously assessed.

Some have been hit harder than others, but during the last ten years most Wyoming counties have been affected. We collected records of delinquent mineral production taxes for the past decade (2006-2016) from 12 counties. Mineral tax delinquencies were found in every county from which data was obtained.[*]

Collectively, those 12 counties have lost out on more than $42 million in delinquent taxes. For small counties, even a few hundred thousand dollars can make a significant difference in operating budgets, and some are dealing with delinquencies in millions or tens of millions of dollars.

The Case of Campbell County

Campbell County has been unable to collect more than $26 million in mineral production taxes owed during the past ten years. The county continues to attempt to collect those debts, but is uncertain whether efforts will succeed.

Most collection efforts are taking place following standard collections procedures, but the county is also attempting to secure payment from one large debtor - Alpha Natural Resources - through bankruptcy proceedings. Engaging in those proceedings, however, does not necessarily ensure payment. Since bankruptcies and subsequent collections proceedings often drag on for a long time, the county will have to wait to find out whether their current efforts pay off.

When Alpha Natural Resources and its subsidiary Alpha Coal West declared bankruptcy in 2015, Campbell County was left

DELINQUENT MINERAL PRODUCTION TAXES BY COUNTY

Campbell------$26,140,002.55

Sheridan---------$7,024,202.71

Natrona----------$5,115,762.17

Sweetwater-------$854,080.79

Johnson-----------$779,723.93

Crook--------------$479,420.86

Fremont-----------$437,320.87

Converse----------$391,397.80

Sublette-----------$300,600.97

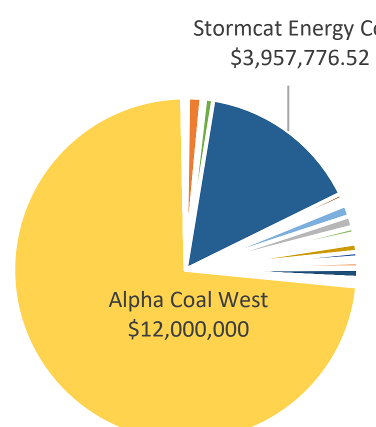
Hot Springs--------$288,939.46

Laramie------------$134,585.36

Weston--------------$75,957.99

Total--------$42,021,995.46

Campbell County Delinquent Mineral Tax



[*] Carbon County was contacted, but did not respond in time to have its information included in this publication

with over $19 million in unpaid *ad valorem* taxes. According to Campbell County Deputy Attorney Carol Seeger, the county hired a bankruptcy lawyer to represent them in Virginia where the bankruptcy proceedings occurred. Unfortunately, the county has seen only partial payment as of December 2017.

Ms. Seeger said most of Campbell County's legal representation is taken care of by county attorneys, but that out-of-state bankruptcy proceedings as complex as Alpha's are outside their capabilities. Bankruptcy is a specialized area of law that requires specific legal knowledge, and the cost for such counsel is very expensive. Seeger puts Campbell County's current legal costs at over $370,000 for the Alpha bankruptcy proceedings, and that cost is increasing as collection efforts continue. When a company declares bankruptcy and proceedings occur out-of-state, the county has to determine whether uncollected debts justify hiring outside legal representation. In the case of the $19 million owed to the county by Alpha, Campbell County decided they did.

House Bill 242 was proposed in 2017 to establish automatic and ongoing county liens on mineral property[2] so that it would be easier for counties to collect tax debt in bankruptcy court. If enacted, this bill would place counties higher on the collections list during bankruptcy proceedings. The legislation passed the House but died in the Senate.[3]

Collections and Recovery Costs

In some ways, Campbell County is fortunate. They at least have some money to pursue unpaid taxes in bankruptcy court, although they will not be able to fight indefinitely. Many counties in Wyoming, however, do not have the funds required to even enter the process in the first place. Efforts thus far have met with some success. Alpha's outstanding debt to Campbell County is down to $12 million. For now, Campbell County continues in its effort to collect the remaining balance. Without further success, however, there will come a time when the expenditure can no longer be justified.

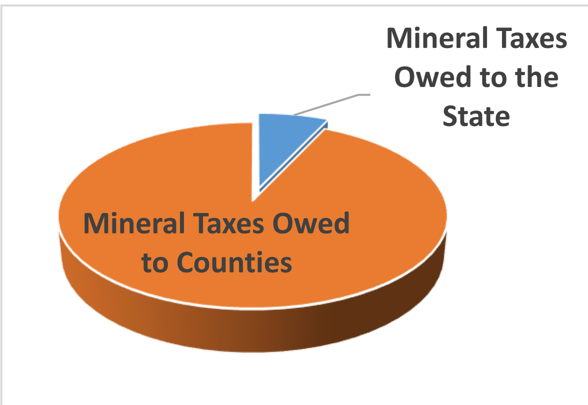
Currently, the state provides no assistance to help counties pay for legal representation in tax or bankruptcy matters. The Federal Natural Resource Policy Account (FNRPA), a fund Wyoming holds at the state level to cover costs associated with participating in federal natural resource policy decisions, with a current balance estimated at over $2 million,[10] could potentially be used to assist counties during bankruptcies. Language in current statute allows for the governor, "with permission," to provide funds to counties to "retain qualified practicing attorneys . . . including providing representation in other forums with the federal government or other state or county governments that may preclude or resolve any outstanding issues."[9] This language could be broad enough to apply to bankruptcies, which are litigated in a federal forum. However, additional clarifying legislation may be required to explicitly allow counties to access this fund during bankruptcies.

Most counties do not have dedicated funding to engage in bankruptcy proceedings. This means they have no recourse when companies declare bankruptcy and they find themselves low on the debt collections list. Without money to engage in bankruptcy proceedings, they simply have to cut their losses and move on. Being able to use the FNRPA account, or a similar state account, to finance county intervention in bankruptcies would help ensure taxes are collected and county interests protected.

Differences in Tax Collection Schedules at State and County Levels

As noted previously, bust cycles hurt the entire state, but they hit counties particularly hard. This is because the state and counties collect mineral taxes on different schedules. The state collects Severance Tax when minerals are severed from the ground. Counties collect *ad valorem* property taxes long after extraction.

According to the Administrator of the Mineral Tax Division of the Wyoming Department of Revenue, Craig Grenvik, severance taxes are paid monthly at the state level. Because of this regular payment structure, the state today is owed less than $3 million from the last bust, according to Mr. Grenvik. The rest - a full 99.977% of all assessed taxes - were paid as owed.



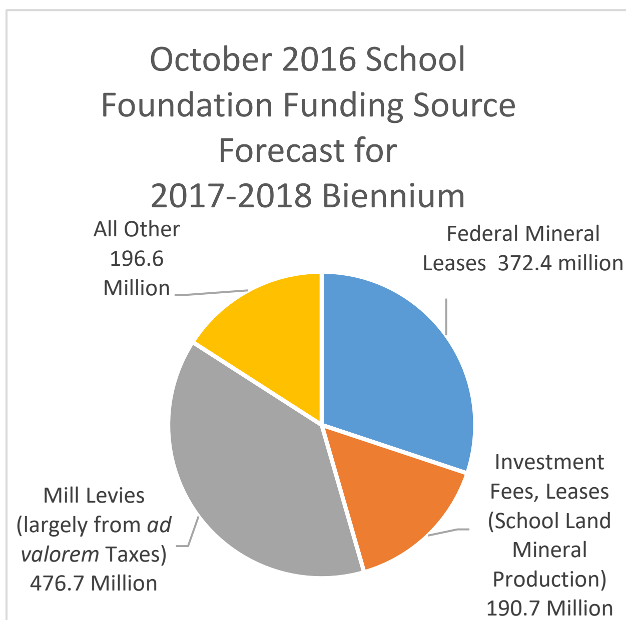
At the county level, however, *ad valorem* property taxes are reported to the Department of Revenue by February 28th of the year AFTER the year of production or sale. Debts are due in full the following December, according to Converse County Assessor Dixie Huxtable. Payments are not due until an average of 18 months after the mineral is produced and sold. A lot can happen in a volatile economy in 18 months, and counties lose a lot more than the state when a downturn hits and a company is unable to pay its taxes.

In 2016, HB0064, sponsored by The Joint Interim Revenue Committee, would have changed the way county mineral *ad valorem* taxes are collected. The proposed law would have structured payment of *ad valorem* taxes more like severance taxes, changing payments to a monthly schedule instead of a yearly schedule.[6] As written, the bill would have phased in the new payment structure over a two-year period to minimize negative impacts on operators. Unfortunately, that bill did not make it through the legislative process.

Impact on Education

The percent of *ad valorem* taxes earmarked for education varies from county to county. It can also vary from year to year depending on the mill rate for education and the mill rate allocated for other purposes. According to Ms. Seeger, however, the percent of *ad valorem* taxes that goes to schools in Wyoming is high in all counties. In Campbell County, about 75% of *ad valorem* tax collected goes toward education[4].

Statewide, Wyoming schools are facing a $644 million dollar deficit for 2016 and 2017, and a projected $400 million dollar shortfall in 2019 and 2020. These numbers do



not take into account capital construction or major maintenance shortfalls, current and predicted, which are also primarily funded by mineral production[5] and lease revenues. An additional $400 million deficit is predicted for 2021-2022. Because so much of our school funding comes from mineral production taxes and severance taxes, bust cycles cause significant harm to Wyoming schools.

Areas of impact in Wyoming school districts may include not only reduction in the amount of funding allocated per student, but also special programs such as: instructional facilitator programs in which exceptional teachers mentor colleagues, and programs for education outside of regular school hours, as well as new construction, and large maintenance projects. For example, until the current bust in mineral revenue, there was a dedicated fund to provide students with summer school and extra-hour assistance. Now this fund has been eliminated. Instead, some money will be provided from the general fund and districts will have to decide how to prioritize their spending, which may or may not include those offerings.

Conclusion

The financial problems Wyoming faces today are not new. Neither are some of the solutions proposed in this report. Recommendations 1 and 2 were proposed in legislation not adopted in 2016 and 2017.

The fact that this legislation was proposed indicates the depth of the problem Wyoming faces. The fact that it did not become law underscores a different problem. We are facing funding deficits at all levels, and in all counties. Yet we Wyomingites do not want to accept that an economy over-reliant on the mineral sector will always suffer bust cycles. The press still reports the downturn “might not be as bad as expected” or that oil prices are recovering…somewhat. Every bit of better news is seen as a trend. Messages of desperate optimism cloud the picture of how dangerous the situation really is.

Many in Wyoming cling to an old mantra: “Don’t do anything to inconvenience the energy industry.” The fact that we have not passed laws that would strengthen government’s financial standing and hold operators accountable reflects a philosophy that places industry needs above the needs of Wyoming counties and citizens. Continuing down this path is no longer a viable option. We need to pass legislation to minimize the damage done to essential government services during busts. There may not be many booms left for Wyoming, and we need to ensure that citizens benefit from minerals that, once severed, will never be replenished.

We have suggested some simple solutions that would strengthen Wyoming’s long-term public prosperity. But this will happen only if we are brave enough to take a stand and change policies which, unchanged, will continue to create financial stress. The time to act is now, as there may be no next chance.

References

1. Johnson, G. (2016, July 8). Alpha deal includes sale of PRB mines. In *Gillette News Record*. Retrieved from http://www.gillettenewsrecord.com/news/article_a7648f15-9c39-574a-b16a-adac6a767e18.html
2. Sponsored by Representatives Barlow and Madden and Senators Driskill and Peterson. (2017). House Bill No. HB 0242: Ad Valorem Tax Liens on Mineral Production. In *State of Wyoming Legislature*. Retrieved from http://legisweb.state.wy.us/2017/Introduced/HB0242.pdf
3. Graham, A. (2017, February 21). Bebout Blocks Bill to Collect Unpaid Mineral Property Tax. *Wyofile*. Retrieved August 12, 2017, from http://www.wyofile.com/bebout-blocks-bill-help-collect-unpaid-mineral-property-tax/
4. Current Mill Levies -August 15, 2017. (2017, August 15). In *Campbell County Wyoming*. Retrieved from https://www.ccgov.net/DocumentCenter/View/11589
5. Joint Education Committee: Subcommittee on Education Deficit Reduction Options. (2016, December 28). Wyoming K-12 Education Funding Deficit Whitepaper. In *State of Wyoming Legislature*. Retrieved from http://legisweb.state.wy.us/lsoweb/WhitePaper Education.pdf
6. Sponsored by Joint Interim Revenue Committee. (2016). House Bill No. HB0064: Monthly payment of ad valorem tax on mineral production. In *Wyoming Legislature* . Retrieved from http://legisweb.state.wy.us/2016/Introduced/HB0064.pdf
7. Chapter 3. Section 4. Bonding Requirements (Forms 8 and 8A, 8E and 8F. (n.d.). In *Wyoming Oil & Gas Conservation Commission*. Retrieved November 15, 2017, from http://wogcc.state.wy.us/wogcchelp/commission.html
8. Coal-SOP-1-08-Permit Transfers. (1998). In *Standard Operating Procedures*. Retrieved November 15, 2017, from http://deq.wyoming.gov/lqd/resources/standard-operating-procedures/
9. Sponsored by Representatives Philp, Eyre, Huckfeldt, Paseneaux, Simons, Wostenberg and Childers and Senators Barton, Cathcart, Coe, Geis and Youngbauer Federal Natural Resource Policy Account. (1999). In *Wyoming Legislature*. Retrieved December 12, 2017, from http://legisweb.state.wy.us/99sessin/engross/house/hb0150.htm
10. State of Wyoming 2019-2020 Biennium Budget Request. (2017). Retrieved December 12, 2017, from https://drive.google.com/file/d/1hkUr2rU _aMQ-1DCqPhQSsgyGprwsCC2X/view

Personal Communications

Craig Grenvik (August 25, 2017)
Jed Cisarelli (September 13, 2017)
Dixie Huxtable (September 19, 2017)
Carol Seeger (December 11, 2017)

Acknowledgements:

This report is dedicated to the memory of Campbell County Treasurer Becky Brazelton, who gave selflessly in her service to the citizens of Campbell County.

This report would not have been possible without the generous help of the following contributors:

State of Wyoming

Craig Grenvik
Administrator, Mineral Tax Division
Wyoming Department of Revenue

Jed Cicarelli
School Foundation Contact
Wyoming Department of Education

Wyoming Counties

Campbell County
Becky Brazelton, Treasurer
Carol Seeger, Deputy County Attorney

Converse County
Dixie Huxtable, County Assessor
Tiffany Martin, Treasurer

Crook County
Mary Kuhl, Treasurer

Fremont County
Candi Cullers, Treasurer's Office Clerk

Hot Springs County
Julie Mortimore, Treasurer

Johnson County
Carla Faircloth, Treasurer

Laramie County
Karen J. Fortney, Treasurer

Natrona County
Tom Doyle, Treasurer

Sheridan County
Pete Carroll, Treasurer

Sublette County
Roxanna Jensen, Treasurer

Sweetwater County
Sue Sanchez, Treasurer's Chief Deputy

Weston County
Susie Overman, Treasurer

Credits

Our appreciation goes to Hesid Brandow, our staff member who conducted the initial research and writing of this publication. Additional thanks go to our staff, Shannon Anderson, Jill Morrison, Robin Bagley and Stephanie Avey, and Board member Bob LeResche for additional research, writing and editing. Above all, credit goes to the contributors listed above and to our members around the state whose continued support made the research in this report possible.

POWDER RIVER BASIN
Resource Council
934 North Main St
Sheridan WY 82801