November 23, 2021

Hon. Rob Bonta
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Anabel Renteria
Initiative Coordinator

Dear Attorney General Bonta:

Pursuant to Elections Code 9005, we have reviewed the proposed statutory initiative related to the extraction and recovery of oil and gas, as well as fossil fuel consumption (A.G. File No. 21-0028).

BACKGROUND

Oil and Gas Production

Oil and Gas Production in California. In 2020, California produced 149 million barrels of oil, and 149 billion cubic feet of natural gas. These amounts reflect an overall decrease in oil and gas production in the state over the past several decades. For example, the amount of oil produced in 2020 represents a 62 percent decrease from the state's peak production in 1985. California's oil fields are concentrated mainly in the southern coastal regions and in the San Joaquin Valley. The state's natural gas fields are mostly located in the northern part of the central valley.

State Regulations. The state's division of California Geologic Energy Management (CalGEM) within the Department of Conservation (DOC) is responsible for regulating the drilling, operation, plugging, and abandonment of oil and gas wells. CalGEM issues permits for the construction of new wells and well stimulation treatments to increase oil and gas production, including hydraulic fracturing (commonly referred to as "fracking") and acid well stimulation. CalGEM collects assessment fees on oil and gas production to offset its regulatory costs. In addition to DOC, there are several state agencies with regulatory and oversight responsibilities over extracting, transporting, and refining oil and gas in the state, such as the State Lands Commission, California Air Resources Board, State Water Resources Control Board, Office of Environmental Health Hazard Assessment, and Department of Fish and Wildlife. These other entities also collect fees from inspection and oversight of oil and gas activities on behalf of the state. California does not collect a tax on extraction of oil and gas.

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Local Regulations. City and county governments vary in their approach to regulating and overseeing oil and gas production. They establish local permitting processes, fees on the production and sale of oil and gas, and limitations to production.

Use of Fossil Fuels

Consumption of Fossil Fuels in California. California's energy consumption comes from a variety of sources, including fossil fuels (such as natural gas and gasoline) and other sources, which are used for fueling vehicles, providing electricity and heating to homes and businesses, and powering industrial machinery. About 72 percent of California's total energy consumption comes from fossil fuel sources. For example, about 40 percent of the electricity used in the state comes from fossil fuels, primarily natural gas, as well as some coal. Combustion of fossil fuels is a major source of greenhouse gas (GHG) emissions in the state.

State Goals and Action for Reducing Use of Fossil Fuels. Legislation enacted in 2016 established the goals for California to reduce its GHG emissions to 40 percent below 1990 levels by 2030. In addition, legislation enacted in 2018 established a state policy that all retail electricity sold in California will be from renewable and zero-carbon resources by 2045. More recently, the state established a policy in 2018 that all new cars and passenger trucks sold in California should be zero-emission vehicles by 2035, and all heavy-duty trucks should be zero-emission by 2045.

The state has implemented several initiatives to help achieve these goals and reduce the use of fossil fuels. This includes regulations requiring utilities to obtain a minimum share of their retail electricity from renewable sources (Renewable Portfolio Standard) and requiring a specified share of vehicles sold by manufacturers be zero emission each year (Zero Emission Vehicle mandate). It also includes various incentive programs to encourage consumers to reduce their use of fossil fuels, such as for the purchase of solar panels and zero-emission vehicles. The state also operates a market-based program called "cap-and-trade," which adds a cost to certain products that result in GHG emissions—such as gasoline—to provide a financial incentive for individuals and businesses to reduce their use of those products.

PROPOSAL

This measure phases out the extraction of oil and gas in California by 2045, as well as prohibits the use of fossil fuels starting in 2050. The measure permits the Legislature to amend some provisions—such as specific dates that provisions go into effect—but prohibits the Legislature from repealing any provisions of the measure.

Phases Out Extraction and Recovery of Oil and Gas. This measure includes several provisions that would phase out all oil and gas production activities in California. This includes prohibiting three particular oil and gas production activities over the next couple of years, as well as the full phase out of all oil and gas extraction by 2045.

- ***Health Protection Zones.*** This measure defines health protection zones as areas within 2,500 feet of a sensitive receptor, such as a hospital, residential area, or school.

This measure prohibits the operation of an oil or gas well within a health protection zone when this measure goes into effect.

- ***Well Stimulation Treatments.*** This measure prohibits the issuance of any permits for well stimulation treatments when this measure goes into effect. In addition, the measure prohibits the implementation of all well stimulation treatments beginning May 2023.
- ***Construction of New Wells.*** This measure prohibits the issuance of permits to construct and operate new oil and gas wells beginning January 2025.
- ***Phase Out of Oil and Gas Extraction.*** This measure sets limits on the amount of oil and gas each entity can extract from its wells. Beginning in 2027, each entity would be limited to extracting no more than the amount it extracted in 2022. The extraction limits become more restrictive over time until all oil and gas extraction or recovery is prohibited by January 2045.

Prohibits Consumption of Fossil Fuels. The measure prohibits state, regional, and local agencies from using coal beginning January 2025. In addition, the measure prohibits the consumption of fossil fuels in the state beginning in January 2050.

FISCAL EFFECTS

The provisions of this measure would have various fiscal effects for state and local governments. We describe the fiscal effects of the measure in two parts—first, the impacts from ending extraction and recovery of oil and gas and second, the impacts of prohibiting the consumption of fossil fuels. While some of these effects will occur decades in the future, our estimates below are in today's dollars.

Ending Extraction and Recovery of Oil and Gas

Decreased State Revenues. Phasing out oil and gas production would likely reduce state revenues over time. In total, we estimate that the revenue reductions related to oil and gas businesses could reach several hundreds of millions of dollars annually. The largest component of the decrease in state revenues comes from a decline in state income tax revenues, which are deposited in the state General Fund. Limiting oil and gas production likely would reduce the revenues from both state corporate taxes and personal income taxes paid by oil and gas businesses and their in-state suppliers, their employees' personal income taxes, as well as owners and employees of firms that service the oil and gas industry and its employees. In addition, there likely would be declines in sales tax revenues paid by companies for equipment used in production, as well as sales taxes paid by oil and gas industry employees and others with jobs induced by the oil and gas industry. Offsetting these tax revenue reductions, however, are potential revenue increases from taxes on new economic activity that might arise in the absence of opportunities in the oil and gas industry. Given the nature of the oil and gas industry in California, it is possible that any offsetting revenue gains would not be significant. Other state revenue sources likely to decline as a result of this measure include the state assessment fee, cap-and-trade auction revenues, tidelands lease payments, and oil transport fees. Declines in certain

state revenues—particularly regulatory fees—could put pressure on the state to raise the existing fees or find other funding sources to continue remaining regulatory and oversight activities.

Decreased Local Revenues. We estimate that phasing out oil and gas extraction would likely reduce local government revenues over time. These reductions could reach a total of several hundreds of million dollars annually. In particular, we estimate that local property tax revenues would likely decline significantly, especially for counties with specific property assessments for parcels with oil and gas reserves. The total also includes reductions in revenues from royalty agreements that some local governments have with oil and gas businesses to generate revenues from the sale of oil produced within their jurisdictions. Other sources of local revenues likely to decline as a result of this measure include local sales tax, extraction fees, and environmental fees.

Revenue Impacts Would Occur Over Time, but With Significant Impacts in Near Term. The measure's limitations on operation of wells in health protection zones, well stimulation treatments, and construction of new wells would likely cause significant oil and gas production declines within a few years. Consequently, while the full revenue impacts to state and local governments are not likely to be reached for a couple of decades, we anticipate that a significant share of the revenue losses would occur over the first few years of the measure's implementation.

Increased State Cost Pressures to Plug and Decommission Wells. This measure could increase cost pressures for the state to plug and decommission wells that are no longer used for extraction and recovery of oil and gas. Typically, oil and gas producers are responsible for addressing these wells when extraction activities cease. Under this measure, an increasing number of wells would need to be decommissioned. As a result, CalGEM would likely incur additional costs to provide oversight and monitor these operators in plugging these wells.

In addition, this measure would likely result in some oil and gas businesses becoming financially insolvent because they cannot generate as much revenue from the sale of the oil and gas they extract in California. In this scenario, CalGEM likely would incur legal fees to litigate with these companies for the costs to decommission these wells. To the extent oil companies cannot pay the full cost to address the wells, the state might face pressure to plug and decommission these wells. Depending on how many wells the state chooses to plug and decommission, the total cost could reach several billion dollars over the next few decades. The exact cost is unknown and would depend on several factors, including the number of wells owned by companies that become insolvent before plugging their wells, the outcomes of legal actions, and the future costs to plug abandoned wells.

Potential State Costs to Address Takings Claims. Because the measure limits oil and gas extraction and recovery in the state, some oil and gas companies and property owners could file lawsuits against the state claiming that these limits constitute the "taking" of value by the government without just compensation. These lawsuits would, at minimum, result in legal costs to the state. If these lawsuits were successful, the state could be required to compensate companies for the reduction in value with costs totaling billions of dollars, potentially over ten billion dollars, over the next few decades. The magnitude of such compensation payments is highly uncertain, and dependent on several factors specific to each site, including the amount of

oil and gas remaining, oil and gas prices, economic conditions, timing of the property purchase, and other characteristics—unrelated to the mineral valuation—of the property.

State Appropriations Limits Consideration. The State Constitution limits how much tax revenues the state can spend each year, with exceptions like spending on infrastructure and emergencies. In recent years, the limit has been an important consideration in state budgeting decisions. The spending that will possibly result from this measure likely would not be excludable from the limit. As a result, it could mean the state would spend more on non-excluded purposes, somewhat increasing the chances that the state would spend revenues in excess of the limit. Revenues in excess of the limit, over a two-year period, trigger a requirement for the state to make taxpayer rebates and additional school payments.

Prohibiting Consumption and Use of Fossil Fuels

Unknown Fiscal Effects. The possible fiscal effects of ending the use of fossil fuels in the state are wide ranging. The net ongoing fiscal impacts are highly uncertain, and depend on the economic, policy, and technological changes that would have occurred without this measure, including state and federal policy decisions, as well as economic conditions that could impact the demand and supply of fossil fuels by 2050.

On the one hand, by 2050, the state might already be close to reducing fossil fuel use to zero, due to technological developments that reduce the cost of alternative energy sources, as well as the various state policies, programs, and goals in place to incentivize alternatives and/or make use of fossil fuels more expensive. Additionally, the global market for fossil fuels could affect future consumption in California if, for example, oil and gas supplies decline and/or their prices rise significantly. High fossil fuel prices would make alternative energy technologies more economically viable in comparison, further encouraging a transition away from fossil fuels. Under this scenario, this measure’s prohibition on the use of fossil fuels would not cause a significant economic disruption and, therefore, might not have major impacts on state and local tax revenues.

On the other hand, while the state might make progress on reducing its use of fossil fuels, the state might still be using a significant amount of fossil fuels in 2050 in the absence of this measure. Under this scenario, the measure’s prohibition on their use likely would create a large economic disruption. There likely would be significant private and public costs to transition to non-fossil fuel alternatives in transportation (for example, electric vehicles and chargers), buildings (such as electrifying appliances and heating systems), and industries (such as developing alternative cement, steel, and glass production processes). Under this scenario, there could be major economic costs associated with the measure, which could, therefore, result in substantial reductions in state and local tax revenues. The magnitude of these revenue reductions is unknown and would depend on numerous economic factors that cannot be predicted.

Summary of Fiscal Effects. We estimate that this measure would have the following major fiscal effects.

- Likely decrease in state tax and fee revenues over time that could reach several hundred million dollars annually, primarily from reduced state income tax and sales

tax paid by oil and gas extraction businesses, their employees, and others with jobs induced by the oil and gas industry.

- Decreased local tax and fee revenues over time that could reach several hundred million dollars annually, including lower property assessment revenues from parcels with oil and gas deposits, as well as lower royalties from oil and gas production.
- Increased one-time state costs and cost pressures potentially totaling more than ten billion dollars over the next few decades to plug abandoned wells and compensate oil and gas companies for the reduction in value.
- Unknown fiscal effects from the prohibition on the consumption of fossil fuels that could range from being relatively minor to substantial reductions in state and local revenues depending on several factors, including economic, policy, and technological changes.

Sincerely,

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for Gabriel Petek
Legislative Analyst

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for Keely Martin Bosler
Director of Finance