Out of Sync with Most Energy-Rich States

A Detailed Analysis of PA Senate Gas Drilling Fee Bill

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Overview

Legislation approved this week by the state Senate would assess an impact fee on Marcellus Shale drilling in Pennsylvania that is well below what gas drillers pay in extraction taxes in many other energy-rich states, such as Texas, Wyoming and Arkansas.

Senate Bill 1100 (PN 1777), sponsored by Senator Joseph Scarnati, would assess $360,000 in fees over a 20-year period on an unconventional well drilled in the Marcellus Shale. The fee is the equivalent of a 2.2% rate on the more than $16 million in natural gas sales that a driller will realize over the 50-year life of an average shale well.[1] A comparable well in Texas would raise $878,500 – nearly two-and-a-half times more than SB 1100.[2] The effective rate on the Senate bill is even lower than a tax plan authored last year by the Marcellus Shale Coalition, which equated to a 2.5% rate over the life of a typical well.

The plan provides little to no new funding for state environmental protection efforts, including Growing Greener. Some of the funds are allocated to counties and local communities outside of the drilling regions; however, the plan provides no funding for education, health care or other core state services.

Assuming 1,500 new Marcellus Shale horizontal wells are drilled per year, we estimate SB 1100 will generate $145 million in the 2011-12 Fiscal Year, increasing to $250 million by 2014-15. The first $8 million of fee revenue is earmarked for the Fish and Boat Commission, county conservation districts, and the State Fire Commission. The remaining revenue is split 55% to local governments in counties with producing wells and 45% to statewide uses such as roads and bridges, water and sewer infrastructure, and hazardous sites cleanup.

The bill also prohibits most local governments from regulating oil and gas activities and gives the Pennsylvania Attorney General greater authority to strike down local ordinances that attempt to limit noise, traffic, or location of wells, pipelines, compressor stations, and processing facilities.

Fee Structure

The bill sets an annual fee structure for horizontal wells drilled into the Marcellus Shale and a reduced fee structure for vertical wells, provided they meet specified levels of daily production.[3]

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[1] The revenue estimate for SB 1100 assumed 3.8 billion cubic feet of production per well. To compare plans over time, we used a constant estimated price of $4.28 per thousand cubic feet over 50 years.

[2] Texas provides a tax reduction for "high cost wells." This projection assumes a 3.75% rate (50% high cost well rate) for the first 10 years of production, then returning to 7.5% in Year 11. Actual rate reductions would vary by well.

[3] Horizontal wells are gas wells that are drilled vertically until they reach a certain depth, then bend to run horizontally, usually in a specific layer of rock. To release natural gas from shale, drillers hydraulically fracture (or frac) the rock with a mixture of water, sand, and chemicals. Horizontal wells use significantly larger amounts of fracking fluids than vertical wells – and typically produce significantly more natural gas, as the bore holes have greater contact with the layer of shale.

The annual fee structure for horizontal wells is as follows:

Year 1 of production	$50,000	Years 4 through 10	$20,000
Year 2	$40,000	Years 11 through 20	$10,000
Year 3	$30,000	Total Annual Fees over 20 years	$360,000

If the average price of natural gas in a year increases above $5.00, the fees would increase. If the price exceeds $8.00 per thousand cubic feet (MCF), the fees would range from $27,500 to $137,500 per year.[4]

The bill would also assess a gas impact fee on vertical gas wells, but at a reduced rate. Wells with production over 180 MCF per day would pay 50% of the scheduled fee; those with production of 90 MCF to 180MCF per day would be assessed 25% of the schedule fee. Wells of any type producing less than 90 MCF of natural gas per day are exempt from this fee.

The fee would be levied by the Pennsylvania Public Utility Commission (PUC) for all wells operating January 1, 2011 or later. The first fees (for calendar year 2011) would be due in the first half of 2012. Fees for future calendar years would be due by March 31 of the following year.

Fee Distribution

As noted above, the first $8 million of fee revenue is reserved for county conservation districts, the Fish and Boat Commission, and the State Fire Commissioner (for training and equipment for local responders to drilling accidents). The remaining revenue is split between local governments (55%) and statewide initiatives (45%).

Local Share. Local governments in counties with producing gas wells split the local share. Counties receive 36%; municipalities that host producing wells receive 37%; and municipalities in the host counties split the remaining 27% by various mechanisms. Local governments are permitted to use the fee revenue for a list of specific uses that are broadly associated with drilling, including (but not limited to) road repair, sewer upgrades, environmental programs, affordable housing, records management/GIS, and the delivery of social services. Fee revenue may also be used to fund tax cuts, including greater homestead exclusions. Local governments receiving drilling fee revenue are required to report how the funds are used each calendar year to the PUC. The PUC is to compile the information into a statewide report that is filed annually with the Legislature.

Statewide Initiatives. Much of the statewide share of the drilling fee is used for grants to local governments and agencies and for the repair of local roads and bridges. The Hazardous Sites Cleanup Fund, which will lose its primary funding source when the state's capital stock and franchise tax is phased out in 2014, receives 5% of the statewide share.

The Commonwealth Finance Agency (CFA) receives 25% of the statewide share to provide grants to local governments and other eligible applicants for acid mine drainage cleanup, plugging abandoned gas wells, sewage facility upgrades, parks and recreation projects, testing of local water, well testing prior to drilling, and watershed

[4] If the price is $5.01 to $6.00, the base fee is multiplied by 1.25; if the price is $6.01 to $7.00, the fee is multiplied by 1.75; if the price is $7.01 to $8.00, the fee is multiplied by 2.25; and if the price is above $8.00, the fee is multiplied by 2.75.

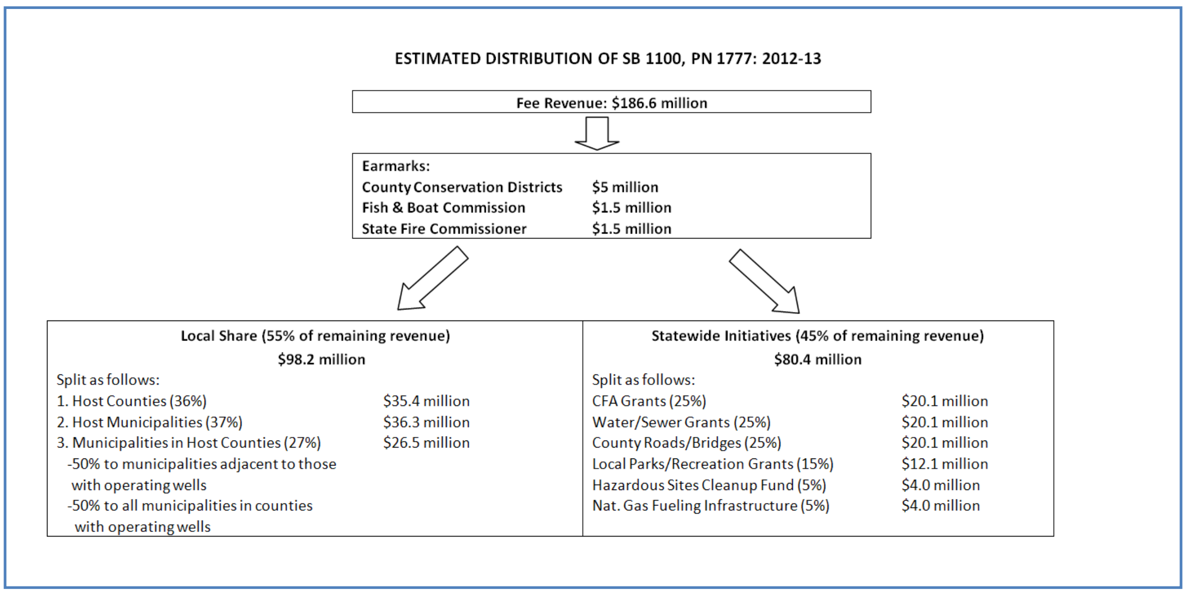
protection. It does not appear that the state agencies that currently do these functions will receive fee proceeds to continue their efforts.

One quarter (25%) of the statewide share is allocated to repairing county roads and bridges. Fee revenue is distributed to counties based on population.

Water and sewer projects receive 25% of the statewide share. Half of this revenue is distributed by the Pennsylvania Infrastructure Investment Authority and the other half is distributed by the CFA under its H2O PA program.

Another 15% of the statewide share is distributed to counties for planning, acquisition, development, rehabilitation and repair of parks, greenways, open space, and other conservation/beautification projects. This revenue is distributed to counties statewide based on population. (The remaining 5% of the statewide share is used to fund natural gas fueling infrastructure projects (through 2013-14). This funding is transferred to the Hazardous Sites Cleanup Fund beginning in 2014-15.

The following chart shows how estimated fee revenue in 2012-13 (from wells operating in 2012) would be distributed under this bill.



One-Time Assessment to Fund Natural Gas Fueling Projects

The bill imposes a one-time assessment on unconventional wells drilled before 2011 to fund the conversion of vehicles to natural gas and construction of natural gas fueling facilities. This revenue would be distributed to local governments, nonprofits, local transit and other authorities, the Pennsylvania Turnpike, school districts, or state-owned or related universities in the form of grants, rebates and low-interest loans. The assessment ranges from $8,000 for drilled but non-producing unconventional wells to $20,000 for producing horizontal wells. The fees would be paid by September 2012.

Regulations and Local Ordinances

The bill makes numerous changes in the environmental regulation of unconventional gas wells, which are beyond the scope of this brief.

If enacted, the bill would void local ordinances that regulate many aspects of oil and gas operations more stringently than state laws and regulations. This includes well location, water or fluid impoundment areas, construction and operations of pipelines, compressor stations, processing plants, and equipment used in such operations. This means that local governments would not be able to require fence heights, noise restrictions, or zoning regulations that exceed state standards. Oil and gas companies would have the right to have the Pennsylvania Attorney General review local ordinances to ensure that they allow "for the reasonable development of oil and gas resources." The ruling of the Attorney General would be final.

Conclusion

The passage of SB 1100 is a small step forward in a lengthy effort to enact a gas drilling tax or fee in Pennsylvania. Nonetheless, this bill lets drillers off the hook too easily and provides little to no benefit for most Pennsylvanians. It also provides no additional resources for the state's primary protectors of our air, water, and land.

Lawmakers need to enact a drilling tax or fee that assesses a rate commensurate with the scale of gas drilling in the Marcellus Shale and comparable to other energy-rich states. A tax or fee should also benefit all Pennsylvanians by investing in education, health services and job creation, as well as the environment and local impacts.

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