Pennsylvania Takes Lead in Taxing and Regulating Fracking

The Marcellus Shale formation and accessing its vast potential via the controversial process of “fracking” continues to preoccupy the industry—and many others. Recently we addressed the narrow issue of how development of the Marcellus Shale interacts with established property law in Pennsylvania. Today we return to the Keystone State to provide what we hope will be a useful analysis of its newest statutory promulgation concerning the future of this new natural gas resource.

BECAME LAW FEBRUARY 13

On February 13, Governor Tom Corbett signed into law House Bill 1950, an act amending Title 58, the oil and gas statutes of Pennsylvania. Be forewarned that the text of the new law runs well over a very dense 70 pages.

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Notwithstanding, its salient points encompasses three paramount topics: (1) imposing a fee schedule to exploit the Marcellus Shale as a new source of revenue for the state; (2) allocating this newfound money over a variety of local and state programs; and (3) instituting a rigorous permit process, which includes input from affected municipalities.

**FEE STRUCTURE**

H.B. 1950 first inaugurates a new Chapter 23 into Pennsylvania oil and gas law. Entitled “Unconventional Gas Well Fee,” it sets forth a detailed schedule for annual fees payable to the commonwealth for drilling *unconventional gas wells*, defined as wells drilled into an “unconventional formation,” in this case inarguably the Marcellus Shale.3

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For every “spud” (that is, the actual drilling of an unconventional gas well), the fees ascend in relation to the price of natural gas. If the annual price of gas is not more than $2.25 (we assume they mean millions of Btu’s here, although strangely for such a detailed law it does not say so), the fee is $40,000 a well. If natural gas exceeds $2.25, the fee goes to $45,000; if gas rises to $3.00, the fee then rises to $50,000, and so on. Certainly, this is a neat way to exploit not only the Marcellus Shale itself, but the overall market as well.

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This schedule is for the well’s first year of existence (and note *existence*, not production). In subsequent years, the fee (still tied to the market price of natural gas) goes down. In Year Two, if gas is below $2.25, the $40,000 fee is reduced to $30,000; if gas is at $3.00, the $45,000 Year One fee is reduced to $35,000 for Year Two. Chapter 23 treats the 1st, 2nd, and 3rd years singly, but then groups together subsequent years (i.e., a well aged four to ten years pays an even more-reduced fee), with the law going out as far as a well’s 15th year of existence. The state’s Public Utility Commission (PUC) is also authorized to assess a $50 a well “administrative charge” upon producers, in order to defray the costs of enforcing the new law.4

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Interestingly, it is not the commonwealth but the local counties that are to impose the fee via local ordinance. Yet the law is quite explicit that any county ordinance must precisely replicate the regimen of Chapter 23. The law furthermore warns that any county that fails to clone its fee structure into local law will not share in the revenue so generated.5

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**WHERE DOES THE MONEY GO?**

Chapter 23 channels all this newfound revenue into a new “Unconventional Gas Well Fund,” to be administered by the PUC. The revenue is then dispersed across an eclectic range of beneficiaries. First to benefit are the state’s county conservation districts, with increasing amounts in the millions of dollars to be distributed to them. A broad range of groups, including the state Fish and Boat Commission, the Emergency Management Agency, and the State Fire Commissioner, are the next beneficiaries.6

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Next, several millions of dollars of the shale tax revenue are slated to be paid into the
state’s Natural Gas Development Program, an entity fundamentally devoted to furthering the use of natural gas as an energy source, via such things as gas-powered motor vehicles and the like.7

Thereafter, Chapter 23 provides for fund monies to be redistributed to the Pennsylvania counties that host the shale wells, on a percentage basis—a sensible approach, given that the counties are the font of these new tax dollars. But the counties are then bound by Chapter 23 to dedicate these monies to road and infrastructure repair, water supply preservation and reclamation, emergency preparedness, and environmental programs, to name a few.8

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Lastly, Chapter 23 establishes the “Marcellus Legacy Fund,” its monies directed to statewide initiatives for environmental protection, maintaining water resources, preserving park land, and other such programs.9

We see how Pennsylvania will now tax Marcellus Shale wells, and where that money will go. The final significant piece of H.B. 1950 goes to the permitting process itself.

AND FOR THE OPPOSITION . . .

For every proponent of developing the Marcellus Shale, there is usually a vocal opponent to its exploration via the controversial technology of “fracking.” And while the commonwealth placed the generation of revenue and its allocation foremost in this new law, it did not forget that opposition. Be mindful that Chapter 32 at its very outset declares its purpose is to “[p]ermit the optimal development” of the state’s oil and gas resources “consistent with protection of the health, safety, environment and property of Pennsylvania citizens.”10 And those environmental concerns are indeed addressed.

After providing detailed definitions of hydraulic “fracking,” the chemicals used in the process, and the water sources that many are concerned about, the new law goes on to provide an exacting procedure for obtaining a permit from the state Department of Environmental Protection (DEP) to drill in such a fashion. Among other things, developers are required to submit periodic and detailing reports specifying with exactitude all the particulars of the chemicals they use in the “fracking” process.11

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Significantly, the law explicitly provides municipal authorities with the right to “submit written comments” about such “local conditions or circumstances” the DEP should consider before issuing any drilling permit.12 The essential thrust of the proviso is to allow municipal authorities (no doubt urged on by concerned residents) to have a say before any well is authorized.

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Chapter 32 goes on to prescribe certain other rules regarding the issuance of drilling permits, including minimum distances to be maintained between the proposed well and bodies of water or wetlands; consideration of the impact of the proposed well upon public parks, rivers, and habitats; and, undoubtedly most significant of all, the explicit requirement that the DEP consider the impact of a proposed well upon “[s]ources used for public drinking supplies.”13

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To assure that water resources are in fact protected, the new statute mandates that any well operator who “affects a public water supply by pollution or diminution shall restore or replace
the affected supply,” with the DEP ensuring that the restored or replacement water meets standards imposed by the preexisting state Safe Drinking Water Act.14

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Clearly, these portions of H.B. 1950 are aimed at assuaging the concerns of many about the environmental impact of “fracking” into the Marcellus Shale. Among other things, we see a rigid permitting process that demands a host of restrictions and other factors must be considered before any permit is granted, an opportunity for affected municipalities to be heard on the subject, and finally the imposition of an absolute obligation upon any developer to replace or remediate any affected water resource.

STATE REIGNS SUPREME

In controversial matters such as this, there are often concerns about conflicting regulations emanating from local authorities. No such concern here: near its end, H.B. 1950 explicitly declares its supremacy over all local ordinances, and the outright exclusion of any contrary local mandates. Concerned parties can therefore take comfort in the fact that they need consult only state law in these matters.15

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CONCLUSION

Pennsylvania has now taken the lead in both taxing and regulating the exploitation of the vast potential of the Marcellus Shale. The newest promulgation will have significant repercussions for the industry in Pennsylvania and beyond. The state’s new statutes on developing the Marcellus Shale and drilling via the controversial process of “fracking” might prove to be the template, or at least the impetus, for similar state regulation elsewhere.

As for Pennsylvania, it is evident that the state appears to have put its first priority on capturing revenue from this emerging source of tax dollars, and putting it to good use for a variety of projects, including those causes that will be most directly impacted by exploration of the Marcellus Shale. But make no mistake: H.B. 1950 likewise makes plain the commonwealth’s insistence that its environment is not to be despoiled, and priority shall be given to the preservation of its natural resources, first and foremost among them its precious water supplies.

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Much remains to be seen about H.B. 1950 and its implementation in the Keystone State. And while it remains to be seen what course the other states chart, Pennsylvania’s new law appears by most accounts to be a step in the right direction, finding balance between the legitimate needs and concerns of those who wish to benefit from this great new energy resource, and those who wish to do so with the safety of the environment assured.

NOTES

3. See Section 2301.
4. See Section 2303.
5. See Section 2302.
6. See Section 2314.
7. See also Section 2701, et seq. (setting forth details as to how this program shall work).
8. See Section 2314.
9. See Section 2315.
10. See Section 3202.
11. See Section 3222.
12. See Section 3212.1.
13. See Section 3215.
14. See Section 3218.
15. See Section 3302–04.