June 5, 2023

The Honorable Greg Vitali, Chairman
House Environmental Resources
& Energy Committee
30 East Wing
Harrisburg, PA 17120

The Honorable Marty Causer, Republican Chairman
House Environmental Resources
& Energy Committee
147 Main Capitol Building
Harrisburg, PA 17120

Dear Chairman Vitali and Chairman Causer:

On behalf of the Marcellus Shale Coalition (MSC), I write to provide you with information and additional context regarding the House Environmental Resources and Energy Committee's (Committee) consideration of House Resolution 131. This resolution directs the Legislative Budget and Finance Committee (LBFC) to undertake a study on the amount of severance tax revenue the Commonwealth may have collected since passage of Act 13 of 2012.

The MSC represents the operators that drill, produce, process and transport unconventional (shale) natural gas within Pennsylvania, along with the supply chain, environmental consultants, contractors and professional service firms that work with the industry. Our producer member companies are the companies that pay Pennsylvania's version of a severance tax, the Impact Fee. To date, Pennsylvania's unconventional natural gas producers have paid over **$2.5 Billion** in new revenue from the Impact Fee. This revenue is above and beyond the billions of dollars in revenue paid by producers under every other tax imposed by the Commonwealth, including the personal, corporate net income, capital stock and franchise (prior to phase-out), sales and use and other applicable state taxes.

As the Committee and House of Representatives consider this resolution, the MSC offers the following background and data for consideration.

Calculation of Impact Fee

HR 131 states that impact fees are collected from oil and gas drilling companies "*based on the number of new wells drilled.*" This statement is not entirely accurate. Impact fees are actually based upon several factors:

1) The total number of unconventional wells a producer owns (not merely 'new wells drilled');
2) The age of the well;
3) The average price of natural gas for the preceding year, as calculated by the Pennsylvania Public Utility Commission (PA PUC) utilizing the settled natural gas price of the New York Mercantile Exchange (NYMEX).

Under Act 13, five different "price buckets" determine which fee amount is utilized for the specific tax year. Impact fees are levied on a well for at least 15 years, and a well which is restimulated must reinitiate paying the Impact Fee as if it was a newly drilled well. Unlike more traditional severance taxes, the Impact Fee must be paid as soon as it is spud and for up to three years of a well's life, even if that well is not producing any natural gas or generating any revenue.

Amount of Impact Fee Paid to Date

One of the provisions of House Resolution 131 tasks the LBFC with determining "*the amount of revenue generated by the impact fee, per year, and the total, since the enactment of Act 13 of 2012.*" The MSC provides this information below for the Committee's awareness. This data is publicly available and derived directly from the PA PUC[1] and the Independent Fiscal Office:

Year Distributed	Amount
2012	$204.2 M
2013	$202.5 M
2014	$225.8 M
2015	$223.5 M
2016	$187.7 M
2017	$173.3 M
2018	$209.6 M
2019	$251.8 M
2020	$200.3 M
2021	$146.3 M
2022	$233.8 M
2023	$270 M (est.)
TOTAL:	**$2.53 Billion**

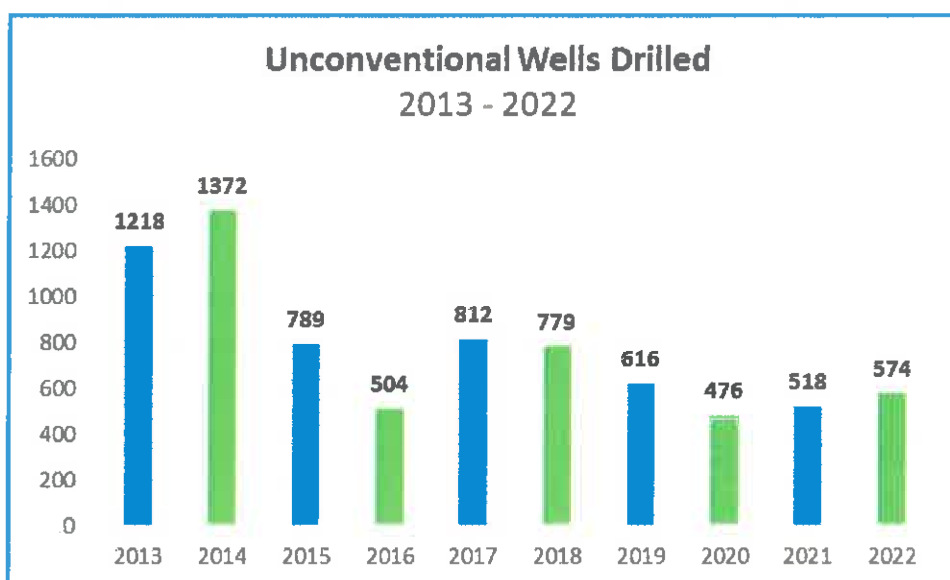
Impact Fee revenue is distributed under an allocation formula laid out within Act 13. It includes funding delivered directly to county and municipal governments for a variety of authorized uses, along with allocations directly to state agencies, including for the purpose of industry oversight. For example, the Pennsylvania Department of Environmental Protection (PA DEP) has received $72 Million to date from the Impact Fee to drastically expand its permitting and compliance personnel.

[1] Under Act 13 of 2012, the PA PUC is charged with administering the Impact Fee. Tax revenue is paid by the unconventional producer no later than April 1st each year and is distributed by the PA PUC to recipients no later than July 1st of the same year. 58 Pa.C.S. §2303

Additionally, funds are distributed to a variety of statewide environmental, conservation and infrastructure funds, including Growing Greener, the Marcellus Legacy Fund, bridge repairs, PennVEST and the H2O program. To date, over $800 Million has been allocated to these various programs. Since 2012, the Impact Fee has been the largest contributor of grant dollars to the state's award-winning Growing Greener program.

Number of Unconventional Wells

HR 131 states that "*approximately 4,000 new wells are drilled each year.*" This is nowhere near accurate. Below is a chart depicting the number of new unconventional wells drilled each year, based upon publicly available data reported by PA DEP:



Severance Tax Calculation

HR 131 states that "*severance taxes are based on the amount of natural gas extracted from wells.*" With the exception of Ohio[2], to our knowledge this statement is not accurate. Typically, severance taxes are based upon a combination of the amount of natural gas and the price of natural gas, minus gathering and transportation costs. As discussed above, Pennsylvania also utilizes the price of natural gas (using a national index price, not a Pennsylvania-specific price) in its imposition of the Impact Fee. While Pennsylvania is the only state to impose an Impact Fee, to our knowledge it is also the only state that prohibits the producer from sharing that tax responsibility with the royalty owner.[3] Many existing leases state that the enactment of a severance tax will be a proportionally-shared responsibility between the producer and the royalty

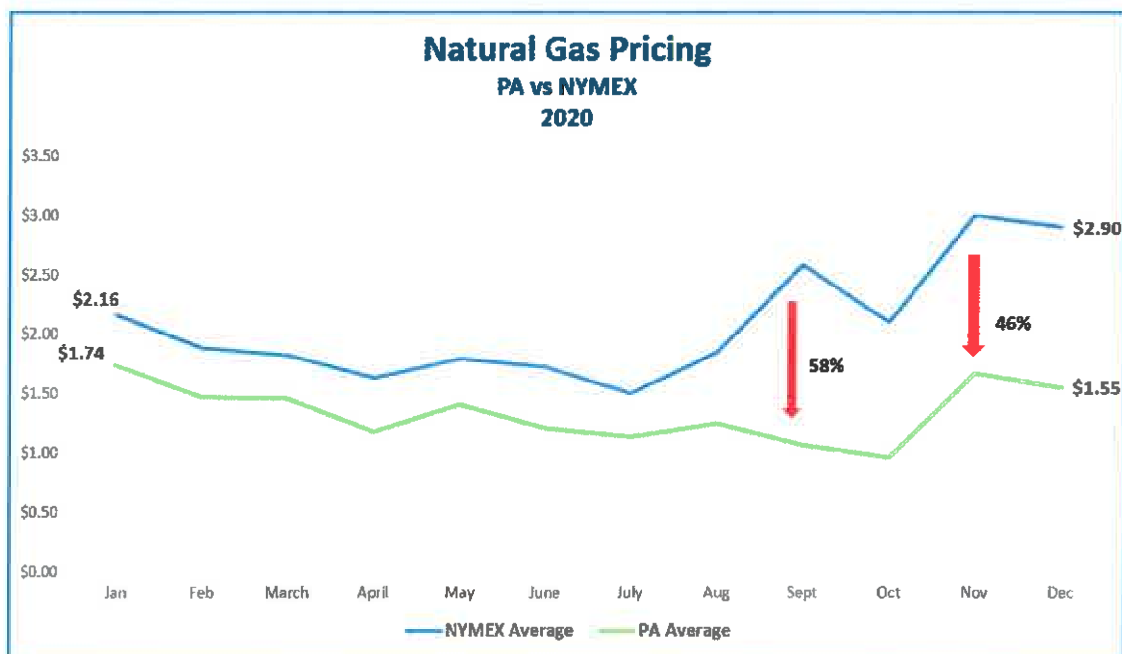
[2] Ohio levies a severance tax solely on a per unit of production basis, at $0.03/Mcf.
[3] 58 Pa.C.S. §3502

owner; legislation that seeks to negate these lease provisions would run afoul of our state constitution's prohibition on contract impairment.

Additionally, states account for a host of other factors when calculating and collecting severance tax. Perhaps most prominent among these is allowing producers to first recover their capital investment on constructing a well before imposing the severance tax.[4] It is fair to say that no two states assess a severance tax in the same manner, or at the same rate, as any other state. Pennsylvania's severance tax – the Impact Fee – is no more unique than any individual state's approach, with the exception that Pennsylvania specifically allocates its revenue for the benefit of local governments and statewide environmental and conservation initiatives.

Price of Natural Gas

With respect to the price of natural gas, it is imperative to understand that because of a lack of infrastructure build out in Pennsylvania – principally pipeline takeaway capacity – prices received by producers and royalty owners in Pennsylvania have been below national index prices for well over a decade. In some situations, this price differential[5] has been severe:



[4] Arkansas, Louisiana and Texas are among these states. Texas reduces its severance tax by 50% - 100% for the first ten years of a well's life until capital costs are recovered, as calculated under a formula devised by the Texas Railroad Commission.

[5] PA Average Price is calculated based upon a weighted production average of three primary sales hubs within the Commonwealth: Eastern Gas (formerly Dominion), Transco Leidy and Tennessee Zone 4 Leg 300. Prices published monthly by *Platts Inside FERC*.

Recent low natural gas prices further illustrate this point. For example, for June 2023 the NYMEX settlement price of natural gas is $2.18/Mcf, while the average Pennsylvania price is $1.18/Mcf. This translates to Pennsylvania producers and royalty owners receiving 46% less for their natural gas than producers and royalty owners in other basins across the nation.

Issues for Consideration by the Legislative Budget and Finance Committee

Calculating how much tax revenue a state may have collected is not merely a mathematical equation. It must involve dynamic economic modeling that considers the totality of a state's overall business and regulatory climate, and the further erosion of capital investment from a state which would have occurred if that business and regulatory climate were further hampered with additional uncompetitive taxes. We are grateful that past General Assemblies have taken these considerations into account in rejecting higher, punitive tax proposals which have been introduced in prior legislative sessions.

Should HR 131 be considered by the full House of Representatives, we are hopeful it is modified so that the LBFC will consider, at a minimum, the following factors in its evaluation:

- Chronically low natural gas prices within Pennsylvania compared to other states due to the inability to permit and construct pipeline infrastructure;
- Capital recovery and other tax deductions or offsets authorized by other states;
- The reduced competitive economic climate within Pennsylvania which would have occurred through the enactment of additional taxes;
- The totality of Pennsylvania's business, tax, and regulatory climate in comparison to the same criteria in severance tax states (e.g. Texas does not have a corporate net income tax and a single permit turnaround time of days, compared to multiple permits that take months, and in some cases years, here in Pennsylvania);
- Total economic contributions to the Commonwealth and local communities, including all taxes paid by Pennsylvania's natural gas industry.

Thank you for your review and consideration of this information.

Sincerely,

Jim Welty
Vice President, Government Affairs