

The Commonwealth of Pennsylvania House of Representatives
Environmental Resources and Energy Committee

Public Hearing on the
Marcellus Shale Play

April 15th, 2009

Testimony of Z. Hunter Hill



Chairman George and other Representatives of the Committee, I would first like to take a moment to say thank you for allowing me the opportunity to testify before you today. I have been very impressed with your Committee's diligence and sense of urgency in understanding the details of the Marcellus Shale Natural Gas Play, and I am glad to be a small part of that very important process. Today I hope to further your understanding of the Marcellus Shale by providing you with the unique prospective of the small, privately held, natural gas company. To give you an idea of what I classify as a small company I will use my own as an example.

Little Pine Resources currently has a total of 13 employees and partners working on this project. Besides our main office, located in Dallas, Texas we also have a satellite office in Clearfield, Pennsylvania. We have spent approximately \$5 million to date, and will need to spend another \$10 million before we can even expect to generate our first dollar of natural gas revenues. Over the next 10 years we estimate it will take an additional \$100 - \$120 million in order to fully develop our initial acreage position. To us and to many others this may sound like a substantial investment, but in the context of the entire Marcellus Shale Play these amounts are a mere drop in the bucket when compared to what some of the other exploration companies are going to spend.

Historically the small private Oil and Gas exploration companies have always played a vital role in the development of most traditional oil and gas plays. The small private producers are quite numerous, and currently these companies are responsible for approximately 30% of the total on shore domestic oil and gas production. If these private companies did not exist, then the finding and development of our nation's oil and gas resources would be far less competitive and much less efficient. Because of our relatively small size, and thus much lower overhead, we are able to make money on the smaller, more fractured projects which are uneconomical for a larger company to pursue. Private companies like us will finance most projects internally, and the principals will take little or no salary. On the other hand most public company executives have a

generous salary and lucrative stock option plan; as well as the luxury of having other people's money to spend on whichever oil and gas projects they see fit. This will cause most public companies to make strategic decisions based on what is best for their stock price in the short term, rather than what may be best for the company in the long run like a privately held company. With that said I will now discuss a few of the issues that we have encountered during our time here in Pennsylvania and more importantly I would like to offer a few ideas on how I think the Commonwealth of Pennsylvania should proceed from here.

Because of the limited amount of time I would like to focus on three main topics today. They are the five year confidentiality period, what to do with the frac flowback water, and the need for more natural gas pipelines.

One of the biggest hindrances on the development of your oil and gas resources is an age old law preventing the DEP from releasing any information publically about a new oil or gas well for five years. This law is especially onerous on the small producers, and if it were eliminated in conjunction with the implementation of new reporting rules on production the competitive environment would be transformed overnight. In any other state I have done business in; I can get access to all recent production data associated with that play on a per well basis. This is an essential tool most small companies use when analyzing any new project. When the first big horizontal Barnett Shale well was discovered in Texas it was only a matter of months before the rest of the industry had access to its production data. By the information being public it allowed many of the small producers to enter the play who could not justify the risk before. This increased competition led to the rapid growth and efficient nature of the Barnett Shale development.

The current requirements on reporting oil and gas production numbers here in Pennsylvania are woefully inadequate and will cause a great deal of problems in the

future if they are not overhauled. A good model to follow is the State of Texas, which requires all operators to report after each month the amount of gas they produced, the amount of gas used, the amount of gas sold, the purchaser of the gas and at what price they sold it at. Also the State requires the gas purchasers to file reports on a monthly basis. With the current annual reporting rules in place, there is no way for a royalty owner to verify his monthly royalty checks until 5 years after the fact, at which time the original operator may not even be around for that royalty owner to seek the proper recourse. There needs to be a system of checks in balances in place to prevent any these actual or apparent discrepancies that will no doubt arise. A new system is needed to protect the honest gas operators as much as it will be needed to weed out the dishonest ones. If the reporting program is done right, the Commonwealth could find a company to come in and bear the bulk of the start up costs and still end up with a new residual monthly revenue stream.

Next I would like to give the committee my thoughts on how to best deal with the issue of frac flowback water. It is in our opinion that a distillation and crystallization process with pre treatment is the only viable option currently available. Unfortunately we are not a large enough company to get a plant built near our acreage, which leaves us in the unenviable position of trying to get other companies to adopt this view or looking to the Commonwealth to help with getting one built. Until this matter is resolved the development of this play will be stymied. One-way or another we need to have this situation clarified immediately. The longer you wait the greater chance of a public backlash against in the entire industry which will not be beneficial for anyone. I would also suggest that the Committees thinks about subsidizing some of the disposal costs in the short term in order to ensure proper handling of these fluids while not stunting the development of the play.

Finally I would like to discuss the current state of Pennsylvania's natural gas pipeline infrastructure. As many of you know Pennsylvania is an importer of natural gas yet did

you know many of your local shallow gas producers are unable to sell their gas all year long. For many months throughout a given year they are shut in by their purchaser because of the lack of local demand for gas or because the pipelines are already full with out of state gas headed to the storage facilities or to the premium pricing markets located further east. The solution to this problem is much more complex than my time will allow today, but I think it is an issue that the people of Pennsylvania should be aware of because it ultimately affects everybody here in the way of artificially high energy prices.

In closing, I would like to say that Pennsylvania has been blessed with an opportunity of a lifetime and the decisions made over the next few months will be felt years for years in the future. In order to get it right the first time we need to align the goals and values of the people of Pennsylvania, the government of Pennsylvania, and the oil and gas companies. If any one of these groups gets to greedy this opportunity may disappear.