Testimony of the Pennsylvania Independent Oil and Gas Association

On House Bill 2443

Before the House Finance Committee
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Delivered by Louis D'Amico
President and Executive Director

I am testifying before you on behalf of the Pennsylvania Independent Oil and Gas Association (PIOGA). PIOGA was formed on April 1st of this year by the merger of the Pennsylvania Oil and Gas Association and the Independent Oil and Gas Association of Pennsylvania. With a membership numbering over seven hundred companies and individuals, we are the largest oil and natural gas producers' association in the Commonwealth.

Our membership is comprised of producers, oilfield service companies and associated industries and businesses whose livelihoods are directly impacted by all actions taken by the General Assembly regarding our industry. Our producer members are active in conventional natural gas and coalbed methane development, shallow oil operations and Marcellus shale development. We also work with the Marcellus Shale Coalition on issues of common interest to their members as well as some of ours.

There has been considerable discussion in the Commonwealth about Governor Rendell's proposal to impose a severance tax on natural gas production. We understand that some confusion has developed on the position of the industry regarding the proposed tax and what the impact will be on the entire industry, and not just a limited number of companies. PIOGA has been and will remain opposed to the imposition of a severance tax on natural gas industry in Pennsylvania. This is non-negotiable - we are not willing to exchange legislative or regulatory remedies or relief for a severance tax. We have taken this position because of the impact it will have on the companies investing in Pennsylvania, the impact it will have on the businesses that rely upon the industry, and for the the following reasons:

1. Impact on Conventional Well Producers: A severance tax will be a real business killer to Pennsylvania's conventional well operators. Pennsylvania has been the third most active drilling state in the country over the last five to seven years in spite of the fact that our conventional wells are marginal producers with a very narrow window of economic viability. The conventional industry is already suffering from the low natural gas prices, leading to a reduction in conventional wells being drilled in 2010 in excess of fifty percent over previous years' activity.

   At $7.50 / mcf gas prices, the Governor's proposal amounts to 30 % of the profit from these wells. Under this scenario most conventional drilling programs will barely break even if the tax is enacted, leading to a total collapse of the conventional industry in Pennsylvania. Even with an exclusion of marginal wells producing 60 mcfd or less as suggested in currently introduced House Bills, or at the 90 mcfd level recognized by the IRS, Pennsylvania's conventional well operators, and their employees, would be heavily damaged. Additionally, the cost associated with purchasing and maintaining individual well measurement equipment – up to $3,000

per well to purchase and $500 per year to operate - to demonstrate the wells meet the stripper well criteria would be staggering to an already struggling industry.

Conventional wells are normally drilled as part of a drilling program. Rather than investing in a particular well, investors invest in programs of multiple wells. Traditionally, an investor will benefit financially from the best wells in a program while either breaking even or losing on the majority of wells. A stripper well exemption would certainly help the money losing or break-even wells but tax the well or wells that are actually funding the investment.

Of particular note on the condition of the conventional natural gas industry is the recent announcement that the largest drilling company based in the Appalachian Basin, quartered here in Indiana, Pennsylvania for ninety-two years, is closing its doors and selling its equipment assets at auction in September. The depressed price of natural gas as well as regulatory and legislative uncertainty has played a major factor in that company's demise.

We simply don't need any additional hardship on our industry.

2. Impact on the Development of the Marcellus Shale: As was clearly indicated in the 2008 Penn State study, the natural gas industry is literally creating thousands of jobs for Pennsylvanians at a time when the rest of the economy is at best stagnant. The report also notes that the industry is investing billions of dollars in Pennsylvania that have a direct impact on Pennsylvania landowners and the local economies where drilling is located. Pennsylvania must compete for investment with the other regions of the nation and other successful shale plays. We will need a tremendous influx of investment capital to meet the infrastructure needs of the Marcellus play that will be heavily impacted by a severance tax. This is a direct investment by private companies and not in the form of a grant or subsidized loan awarded by state government. In many of the other producing areas, the infrastructure is already in place to handle additional production capacity, a luxury that the Commonwealth does not have. Therefore, businesses are faced with difficult decisions every day of where to direct these limited resources.

   One of the shale plays we will be competing against is the newly discovered Eagles Ford shale in Texas. Proponents of a severance tax are quick to point out the number of states with severance taxes. Although Texas has one, the tax allows for recoupment of investment before taxing a well. While these wells will enjoy almost a decade of development prior to payment of a single tax dollar, Pennsylvania will

demand immediate payment upfront before any recoupment of investment. We must compete for investment dollars in this economic atmosphere.

Every nickel taken from the industry in taxation is one less nickel going into the ground in investment to create new supply of domestic energy and desperately needed new jobs for Pennsylvanians. Since the royalty owners will also be subjected to this tax, it means less local dollars for residents to spend in the state's economy. Although it may seem "prudent" or "heroic" to tax out of state companies it seems far less so to tax landowners who have fought for generations to keep their family farms as well as producers who have supplied jobs to Pennsylvanians for a century.

3. A Proposed Tax is Focused on the Bright Spot in Pennsylvania's Economy: A third consideration is the Constitutionality of singling out one extractive industry for a tax while excluding other industries – coal, sand and gravel and bluestone. We do not advocate taxing those industries – we don't support job killing taxes in any industry, ours included. We have heard from many directions, particularly from the environmental community, that imposing a severance tax will in some mysterious way prevent the kind of environmental issues created by the coal industry one hundred years ago…long before there was a Department of Environmental Protection and state laws and regulations developed to provide a balance between the environment and the responsible development of these private resources.

It is exceedingly frustrating to our industry to be singled out the way it has been in the last year, while trying to grow investment, jobs, and supply of clean natural gas energy in the Commonwealth. It is shocking to see the almost daily efforts by Pennsylvania's government leaders who are passing out tax incentives, tax breaks and low interest or interest free loans to companies to create twenty, thirty or one hundred jobs, or for companies that agree to keep a portion of their business and employees in Pennsylvania. However, the natural gas industry is not asking for a government hand out to create tens of thousands of jobs. Yet, we are confronted daily with proposals to create new fees, taxes, and regulations that would result in the halting of these investments.

Our mission as an industry is simple – provide clean energy to our industries and homes, create fair paying jobs for our neighbors, conduct our business in a safe and environmentally sound manner, and provide a profit for owners and investors. As an association, our mission is to work with legislative and regulatory bodies to assure the industry mission can be accomplished.

Clearly as part of that mission we feel strongly that the imposition of a severance tax prohibits the industry from reaching these goals and further will negatively impact Pennsylvania's communities that rely upon the natural gas industry and the jobs its creates.