



House Environmental Resources and Energy Committee Chairman Camille "Bud" George's May 2010 Update: **SPECIAL UPDATE ON SEVERANCE TAX & FORCED POOLING & HB 2213**

Background

I have little doubt that the House will pass a severance tax this session. But when it does, we should be ready for what will come back to us. It is almost certain that the Senate will amend any severance tax bill with a controversial, ugly provision top on the list of the natural gas industry: **forced pooling**.

Pooling

Pooling is a practice used by oil and gas companies to group adjoining mineral rights leases to form a larger drilling unit. This is an important issue for producers seeking to drill horizontal wells because a larger land unit would allow for longer and more cost-efficient drills. Typically companies attempt to pool through agreements, but when they encounter mineral rights owners who are unwilling, for whatever reason, to lease their rights, the companies have resorted to "forced pooling."

Forced Pooling

Forced pooling is a government process by which the unwilling or unavailable mineral rights owner would be forced to lease his or her interest in exchange for a royalty share. Currently, some form of forced pooling exists in Oklahoma, Louisiana, Texas, Colorado and New York, although the applicability of forced pooling as well as the rights and duties of those force-pooled vary considerably. The process is that a gas producer would file a pooling application with the appropriate government agency, and following notice and an opportunity to respond, the agency may issue a pooling order setting forth the terms and conditions of the forced pooling, including compensations for the unwilling owner.

Issue: Economic Efficiency v. Eminent Domain

Proponents of forced pooling assert that, as a policy matter, pooling promotes economic drilling and limits the environmental footprint of drilling. They also assert that pooling protects the interests of the willing mineral rights owners in the drilling unit who want to maximize their financial benefits and also protects the unwilling owner by counteracting the Rule of Capture—which states that any gas migrating from an unleased property into a well drilled on a leased property is fair game for extraction.

However, critics of forced pooling call it an eminent domain for mineral rights for the pure benefit of private companies. According to a local newspaper article, a mineral rights owner in Fort Worth, Texas, who refused to lease his mineral rights--for the simple reason that he did not want to be part of the gas development in his neighborhood, called forced

pooling "compelled leasing" with "an eminent domain essence." He asserted, "This is my house, these are my minerals and I want to be the one who makes those decisions."

The Pittsburgh Business Times, in its February 5, 2010 article, predicted that the issue of forced pooling "is likely to heat up, as companies increasingly look to drill in more urban areas." It noted that Chesapeake Energy Corp. has been acquiring many small tracts in urban areas in Pennsylvania, including Lawrenceville and West Mifflin.

Pennsylvania Law

In Pennsylvania, there already exists a forced pooling provision in the Oil and Gas Conservation Law, but there is no official record indicating that this law was ever invoked or used. The provision would allow a currently non-existent Oil and Gas Commission to administer forced pooling applications and issue a forced pooling order after a public hearing. Importantly, this provision applies only to wells penetrating the Onondaga formation, just below the Marcellus, and Marcellus wells thus would not be covered.

Property Rights Sentiment in Pennsylvania

Following the deeply unpopular U.S. Supreme Court decision in *Kelo v. City of New London*, in which the court validated a local municipality's condemning of two private homes to turn them over to a private developer, Pennsylvania, along with 31 other states, condemned the decision and swiftly moved to toughen the requirements for condemnation. Acts 34 and 35 of 2006 were signed into law, making it more difficult to declare blight and prohibiting the use of condemnation strictly for purely private benefits.

Budget Negotiations

Any severance tax bill that will be part of budget negotiations this year may spell trouble for the House Democrats and a win-win situation for the natural gas industry. As I have said, it is almost certain that any severance tax bill passed by the House will be amended by the Senate with a forced pooling provision. Once the word gets out, such provision is likely to be met with fierce public opposition, for good reason—an intrusive government would be depriving an individual's property rights to benefit private companies. The House Democrats will feel intense pressure to concur with the Senate amendments in order to enact a severance tax that will be necessary to fill a budget hole. They will face an ugly choice—either vote for the tax and for forced pooling and face the populist outcry, or reject the Senate amendments and forgo the severance tax. For the industry, it will either gain force-pooling or be saved from the tax. Once again, we won't be happy with the outcome.

HB 2213

The gas industry touts the environmental benefit of forced pooling, but we know the real reason for forced pooling is money. To protect the environment, including our waterways and drinking water, we must amend the badly outdated Oil & Gas Act. My HB 2213 contains provisions that will protect our drinking water sources and environmentally sensitive watersheds and place reasonable environmental safeguards on drilling activities. HB 2213 must be part of any solution to mitigate the environmental harms of gas drilling.