

**Testimony of the**

**Independent Oil and Gas Association of Pennsylvania**

**And**

**Pennsylvania Oil and Gas Association**

**On HB 10**

**Before the Pennsylvania House Finance Committee**

**February 2, 2010**

**Good afternoon, Chairmen Levdansky, Chairman Rohrer and House Finance Committee Members. My name is Lou D'Amico, Executive Director of the Independent Oil and Gas Association of Pennsylvania (IOGA). In addition to speaking for my organization today, I will also be speaking on behalf of the Pennsylvania Oil and Gas Association (POGAM).**

**I appreciate the opportunity to speak today about House Bill 10. Eight years ago, IOGA won a landmark case against Fayette County before the Pennsylvania Supreme Court. The decision stated that there was no authorization for taxing oil and gas as real estate by the General Assembly. The purpose of this bill is to undo that decision and the work that went into achieving that result. Obviously, IOGA and POGAM are opposed.**

**The case which IOGA presented covered many issues which we felt clearly indicated that the idea of taxing these fluids as real estate were flawed. The unanimous decision only focused on the lack of authorization. Significantly, two of the justices, Justice Nigro and Justice Saylor, did observe in their concurring opinions that due the difficulty in accurately assessing how much oil and gas may be produced from a property, taxing it as real estate would not be appropriate. Their opinion states that the "Appellees lacked the statutory authority to tax Appellants' interests because oil and gas are of fundamentally different character than real estate."**

**The fundamental difference to which they addressed is the fugacious nature of natural gas and crude oil. Fugacious nature refers to the ability of oil and gas to flow freely within a geologic formation. The fluids can flow long distances depending on the porosity and permeability of the formation or fractures within the formation. Therefore, natural gas from one farm may to some extent flow to a well on another farm or affect the pressure gradients within the formation. Adding another well in the vicinity can change the direction and rate of the flow as well as the ultimate recovery of reserves from a well.**

**Pennsylvania is a law of capture state. Gas or oil is not able to be sold until it is 'captured' by a well. A reasonable calculation of reserve life in that**

**well can and is dramatically changed by the drilling of adjacent wells. So a well can have a portion of its reserve drained by an adjacent well on the next property by another producer or have diminished recovery due to changes in the pressure profile within the formation.**

**Petroleum reservoirs are complex environments. There is no physical way to determine with any kind of confidence what hydrocarbon (oil or gas) volume lies beneath any property or how much of that hydrocarbon can ultimately be recovered. There are variations of porosity and permeability throughout the formation. Calculation of the volume to be expected from a particular well is complicated by these physical attributes.**

**I am a Petroleum Engineer by background. I have been trained to make certain inferences about the volume of oil and gas in place in a reservoir. However, I cannot pretend to be an expert on this field. Certainly the county assessment offices will not be able to make these calculations. They must be made by some outside entity.**

**There are individuals who will say they are competent to make these calculations. It is of particular interest though, that US public companies use fewer than ten companies across the nation to make these calculations for their independent reserve analyses. The bulk of these calculations are made by three companies.**

**Calculation of volumes is only the first step. One must apply a value to these reserves. Unlike a house which will be given an appraisal value once and then keep that value until a county-wide appraisal, oil and gas prices are volatile and constantly changing. Crude oil and natural gas prices have wild price swings caused by variations in supply and demand as well as other issues such as political stability of producing countries, refinery shut-downs for repair, pipeline interruptions and hurricanes.**

**Throughout the life of a well, the assumptions that go into reserve calculations constantly change. Add to this the impacts of offsetting wells, price volatility, and natural declines in production as reserves deplete and it is obvious that each year the assessment of a wells value will change. This will be a large cost to the counties if the assessments are done correctly.**

**Based on the fugacious nature of the fluids and the characteristics of these fluids, I believe the courts will reject assessment of oil and gas as real estate as unconstitutional if the General Assembly passes this bill.**

**I understand the temptation of a legislative body to tax the oil and gas industry. With high gasoline and natural gas prices we are always a tempting target. However, the industry is not the only group that will pay this tax if passed.**

**Most of the oil and natural gas ownership is not severed. Surface landowners and farmers own most of the mineral estates within the Commonwealth. Clearly the uniformity clause of the Pennsylvania Constitution prohibits taxing one of the owners of a mineral estate unless all owners are uniformly and equally taxed.**

**The royalty owners get a minimum one-eighth of the gross sale value of a well's production. That value is fully subject to any tax. In addition to the uniformity clause, standard leases throughout the industry clearly state that taxes of all sorts are deductible from royalty.**

**Many small farmers depend on royalty payments to help keep the family farm. Any loss of revenue from taxation could be crippling to those farmers.**

**The industry will also be damaged by these taxes. When the first Arab oil embargo forced prices to escalate dramatically the U.S. Congress passed a so-called Windfall Profit Tax. The tax was designed to "punish" producers for making a larger profit. It was a successful tax. It did punish the industry as well as the American people. It enriched the U.S. government. However, since the increased profits were not redirected to drilling and exploration for new reserves, we went from a 30% dependency on foreign oil to over a 70% dependency today. It also cost 1,250,000 Americans their jobs and caused most the major oil integrated companies to all but abandon U.S. onshore production.**

**Pennsylvania has been the third most active state in the nation for drilling, primarily for natural gas. We have added jobs and invested heavily**

**in the Commonwealth to meet the needs of Pennsylvania consumers. We currently supply 26% of the demand for natural gas in this state, saving consumers millions of dollars in pipeline transportation charges to bring gas from other producing regions. This contribution will rapidly increase with the development of Marcellus shale wells**

**For those who think increased taxes will not damage the industry, one need look across the state line to see differently. Through most of my career, West Virginia was at least as active in drilling and producing natural gas as Pennsylvania. This trend has reversed dramatically in the last decade as West Virginia's government continued to increase taxes on the industry.**

**Existing tax burden on Pennsylvania is lower than West Virginia but 30 percent higher than New York and nearly double the tax burden in Ohio. How much higher does our tax burden have to become?**

**I am sympathetic to concerns of local governments and school districts for the need for increased funding. However, I believe that these folks should be receiving their fair share of revenues already collected by the state government. Perhaps the state should consider a better distribution of the promised windfall of tax revenue from the gaming industry in Pennsylvania rather than limit the investment in new oil and gas wells in the Commonwealth, or distribute more of the taxes already collected on our industry, our service companies, our royalty owners and our employees.**

**The oil and gas industry in Pennsylvania has little impact on the local governments in the Commonwealth. The only impact is on highways due to the heavy traffic load on local and state roads. Yet the industry is directly responsible for repairing and replacing road damage caused by our operations. Millions of dollars have already been spent by the natural gas industry to repair and replace local roads impacted by our activities. In most cases road quality has increased in areas involved in active drilling in order to accommodate future drilling. These improvements come at no cost to the taxpayer.**

**This testimony is virtually the same that was delivered by me in September 2007 on a bill designed to accomplish the same result as HB 10.**

**The only thing that has changed is the beginning of developing Marcellus Shale in Pennsylvania.**

**This fledgling industry is already adding jobs and investment to the Commonwealth. The future holds opportunity for upwards of 100,000 plus new quality jobs to be brought to Pennsylvania. The companies developing this shale have and will be investing hundreds of millions of dollars in this state.**

**It is imprudent to add new taxes to the financial burden these companies are bearing to drill wells and develop hundreds of miles of new pipeline facilities and train incumbent workers to perform the necessary work with Pennsylvanian workers.**