PIOGA Testimony
Joint Hearing before the Pennsylvania
Senate Environmental Resources and Energy Committee and the Senate Finance Committee
June 1, 2015

Good morning Chairman Yaw, Chairman Yudichak, Chairman Eichelberger, and Chairman Blake.

Thank you for the opportunity to testify regarding the various proposals for a severance tax on natural gas and natural gas liquids produced in Pennsylvania. I am testifying on behalf of PIOGA, the Pennsylvania Independent Oil & Gas Association. My members, numbering approximately 750, include large multi-national integrated oil and gas companies, shale producers, traditional conventional natural gas producers, shallow oil producers and coalbed methane producers. Roughly five hundred member companies are service providers for the industry, and most are owned by Pennsylvanians and based here. These members employ a significant portion of the estimated 250,000 Pennsylvanians whose employment is dependent on the oil and gas industry. These are the "special interests" I proudly represent.

It is appropriate that I say upfront that I oppose the Governor's severance tax proposal and each and every other severance tax proposal in the General Assembly. I oppose the tax, not only because I represent this industry, but also as citizen of the Commonwealth since birth, I oppose any taxation that singles out a particular industry or business in Pennsylvania for special tax treatment above and beyond the treatment afforded every other business in the Commonwealth. In my sixty-four years, I have seen far too many jobs lost to other states and other nations directly resulting, in my opinion, from politically driven actions taken inside this building. I would oppose this kind of special tax treatment even if this were the most profitable business in the Commonwealth, now or anytime in the future.

Unfortunately for my members, this is simply not a profitable time to be in the oil or natural gas business. For oil producers, actions by the Saudi's and the success of the shale oil finds in North Dakota and Texas have dramatically impacted any profitability in Pennsylvania's oilfields. Similarly, the shale gas revolution nationwide has created far more natural gas supply than demand, a situation many predict will last several years. Couple that with the higher than average cost of drilling for both resources in Pennsylvania as a result of weather, terrain and far more rigorous regulation than other states, Pennsylvania's producers are struggling to survive, let alone profit, in the current and reasonably foreseeable situation. Our industry has been a victim of its own success.

Production capability in Pennsylvania has also far outstripped the pipeline infrastructure needed to move gas out of the Appalachian region. Most experts expect it will be 2017 at the earliest that sufficient infrastructure is in place. Even if that is the case, supply of natural gas will still outstrip demand for the commodity. Additional demand will have to come from manufacturing and the replacement of coal-fired electric generating plants. These things clearly will not take place overnight, even without the unreasonable efforts of those opposed to pipeline development based on false science and unlawful legal theories.

Our state's conventional producers were already severely impacted by competition for markets and price pressure from shale production. There is little in the way of investment dollars to invest in the marginal well production that supplied most of Pennsylvania's pre-shale natural gas industry.

Regulations that were created to address perceived impacts of shale drilling bled into Pennsylvania's regulatory oversight of these conventional producers. This part of the industry is severely struggling -- if not dying -- as a result. There is no room for even a penny of extra burden on the economics of these wells.

Unconventional wells don't have a much brighter picture in Pennsylvania at this time. Before one even considers the burden of extra taxation or extra regulatory cost on the shale industry, it must be recognized that the per-foot drilling costs in Pennsylvania are already among the nation's highest – a problem shared with our neighbors in Ohio. Those companies drilling the shale have far higher requirements for capital than conventional producers. They must compete for capital not only within their companies and in the U.S, but worldwide. Those dollars flow to the opportunities of greatest potential return. Today's economic environment and challenge of investment availability has already forced those producers to cut capital budgets and reduce drilling plans. An additional tax burden will do nothing but extend the time it will take those companies to become active developers of natural gas in Pennsylvania. Until prices significantly recover, large sections of the Marcellus and Utica play in Pennsylvania will not be drilled. If drilling new wells at all, companies will be forced to focus on the areas where infrastructure currently exists or is planned – mainly the areas of Southwestern and Northeastern Pennsylvania where drilling has already occurred.

People are losing jobs in this industry already, as a result of the economic environment. Adding a severance tax will do nothing but lead to the loss of more jobs and reduced capital expenditure programs, and further dampen the state's economic recovery. This is glaringly apparent, yet for some reason many members of the General Assembly and certainly everyone in this administration are oblivious to it. How many more opportunities will Pennsylvania have to thrive as an economic powerhouse and how many more times and ways will our political class find a way to sabotage that opportunity and its accompanying middle class job growth?

Pennsylvania is in a unique position in the U.S. With the huge potential reserve and supply of natural gas, the Commonwealth has a tremendous advantage to leverage this resource for manufacturing and electric generation. The job creation engine that our industry has become will be even larger if we establish the right government policies to bring new business and manufacturers to the Commonwealth. The Governor and General Assembly should be looking directly at policies to enhance this industry as leverage to help it fully develop into an attractive alternative for manufacturing. Low energy costs, proximity to consumer markets and a trained workforce are all key factors in attracting these employers, and our natural gas is probably the most important of these three in terms of cost and reliability. This should be a long-term focus of our state's leadership. I am sure by now you have all seen the study Dr. Timothy Considine prepared showing that a severance tax would actually result in fewer jobs and generated tax dollars in Pennsylvania. If not, I will be happy to forward you a copy. This is an important study to consider as you contemplate a severance tax.

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I think it is important to discuss some misinformation and misconceptions present in the Governor's severance tax proposal. He touts his proposal as "modeled on" and having the "same" or "similar" structure as West Virginia's severance tax, apparently uninformed that the WVa tax has left that state far behind Pennsylvania in wells drilled and jobs created, which has generally repressed that state's economy compared to Pennsylvania's.

More to the point, his proposal is dramatically different from WVa's severance tax, with these the most glaring examples:

●First, WVa's tax is imposed on the value of natural gas at the wellhead because the actual sale prices received are reduced by transportation expenses to get the gas to market. In contrast, the Governor would impose the tax on dry natural gas based on a 3-month average market price at interstate pipeline hubs with no expense allowance to net back the sales price to the wellhead. Natural gas liquids are treated the same in the Governor's proposal: the tax would be imposed on the gross sales proceeds without any expense allowances.

●Second, the Governor's proposal establishes minimum or "floor" prices for dry natural gas – $2.97/Mcf – and natural gas liquids – $20/barrel – while WVa does no such thing. Given the dramatic discount Pennsylvania gas is traded compared to Henry Hub, NYMEX or Southpointe hub pricing, this would be a huge adverse financial impact.

●Third, WVa's 4.7¢ severance tax component is earmarked for eliminating that state's unfunded Workman's Compensation debt and is set to expire when that debt is paid, in 2016 or at most, 2017. The 4.7¢/Mcf in the Governor's proposal is neither earmarked for any special purpose nor set to expire.

●Fourth, WVa's tax respects agreements between mineral owners and producers, allowing the sharing of the severance tax expense with mineral owners as provided in agreements. The Governor's proposal would prohibit – many believe unlawfully – such sharing, demanding that producers pay 100% of the tax. This is an average of 80-85% of the revenue, which effectively increases the tax rate by 15-17% by attempting to overturn existing agreements that allow such sharing.

●Fifth, and by no means final, WVa's tax does not target exclusively natural gas producers, but applies to all extraction industries – including coal, timber, and gravel, for example. Make no mistake, I am not suggesting that a severance tax should be imposed on these other industries, which also – as does my industry – pay the same taxes as required of every other Pennsylvania business.

In conclusion, the severance tax is by no objective, informed or reasonable analysis a fair or "commonsense" tax. The severance tax is bad public policy, targeting one industry and one alone to achieve particular goals that are not attainable in any event by the proposal. This proposal will cost jobs, increase energy costs for our citizens, and squander the opportunity to make Pennsylvania an attractive state for business and investment. This is clearly the reason why the business community, led by the Pennsylvania Chamber of Business and Industry, has spoken loudly against this proposal specifically and a severance tax generally.

I have heard it said in Harrisburg that Pennsylvania ranks 48th of the 50 states in job creation. I'm not sure that I buy that statement, but if it is indeed true, there is something for the states ranked 49 and 50 to take as encouragement. If Pennsylvania does impose a severance tax, Pennsylvania will assume the pole position in the race to the bottom.

Thank you.