

Prepared Testimony of
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Introduction

Good morning Chairman Sturla and members of the House Democratic Policy Committee. I am Gladys Brown, Chairman of the Public Utility Commission (Commission). I am here today, on behalf of the Commission, to offer testimony concerning the Commonwealth's existing impact fee on natural gas producers.

Before I begin I wish to convey that the Commission remains agnostic as to any natural gas severance tax policies. It is my intention with this testimony to provide a background on the impact fee, explain how the Commission administers the fee, and update you on recent developments regarding the audit of the impact fee and the Commonwealth Court's interpretation of statutory language related to the impact fee.

Act 13 of 2012

Act 13 of 2012 (Act 13) was signed into law by Governor Corbett on February 14, 2012. Act 13 modified Title 58 (Oil and Gas) of the Pennsylvania Consolidated Statutes by, *inter alia*, directing the Commission to: (1) calculate an impact fee payable by producers with qualifying spud unconventional gas wells in the Commonwealth, (2) collect this fee from producers, and (3) distribute the funds received from the fee among state agencies and local governments to be used for specific purposes.

Each eligible unconventional well is subject to a fixed fee based on two components: (1) the age of the well from spud date, in years, and (2) the average annual price of natural gas as established by the New York Mercantile Exchange's Henry Hub Natural Gas Futures Contract (NYMEX price). Each well is subject to a decreasing established fee schedule which is based on the age of a particular well from spud date. As the reported NYMEX price increases, the fee applicable to each well will also increase within the established fee schedule tiers. Depending on the NYMEX price, horizontal wells which are within one year of spud date are subject to an impact fee ranging from a floor of \$40,000 to a ceiling of \$60,000. To demonstrate the decreasing fee schedule over time, at 11 to 15 years the same horizontal wells are subject to an impact fee ranging from a floor of \$5,000 to a ceiling of \$10,000.

Each qualifying unconventional gas well is subject to the impact fee on a calendar year basis. Producers must submit fees to the Commission by April 1st of

each subsequent reporting calendar year. For the 2015 reporting year, the Commission collected a total of \$187,711,700 in impact fees from 81 producers. After the fees have been collected, the Commission must distribute the fees by July 1st. For the 2015 reporting year, the Commission distributed funds amongst the following entities as required by law:

- County Conservation Districts/State Conservation Commission - \$7,545,000
- Fish and Boat Commission - \$1,000,000
- PA Public Utility Commission - \$1,000,000
- Department of Environmental Protection - \$6,000,000
- PA Emergency Management Agency - \$750,000
- Office of the State Fire Commissioner - \$750,000
- Department of Transportation - \$1,000,000
- Counties, Municipalities, and the Housing Affordability & Rehabilitation Enhancement Fund - \$101,800,020
- Marcellus Legacy Fund - \$67,866,680

The number of distinct entities receiving funds totaled over 1,500, including 1,487 municipalities and 37 counties. Annual collections have ranged from a high of \$225,752,000 for the 2013 reporting year to the aforementioned \$187,711,700 collected for the 2015 reporting year. Since the passage of Act 13, the Commission has collected and distributed just over \$1 billion.

Act 13 places a restriction or cap on the amount of impact fee funds municipalities can receive. This cap shall not exceed the greater of \$500,000 or 50% of the municipalities previous years' total fiscal budget. Based on this restriction, the Commission requires municipalities to annually submit their budget information in order to accurately calculate the applicable cap.

Municipalities and counties receiving Act 13 monies are required to use the funds for the following thirteen purposes:

- Construction and repair of roadways
- Water system construction and maintenance
- Emergency preparedness and public safety services
- Environmental programs
- Preservation and reclamation of water supplies
- Tax reductions
- Projects to increase the availability of safe and affordable housing
- Records management, geographic information systems, and information technology
- Social services

- Judicial services
- For deposit into the county or municipality's capital reserve fund if the funds are used solely for a purpose set forth in this subsection.
- Career and technical centers for training of workers in the oil and gas industry
- Local or regional planning initiatives

Each municipality and county reports to the Commission the amount of funds used for these enumerated purposes. This data is conveyed to the Commission via a standard form, due by March 1st of each year and applicable to the expenditure of Act 13 funds for the previous calendar year.

The Commission compiles all relevant data associated with its administration of the impact fee into an annual report. This data includes, but is not limited to, the number of producers, total dollars distributed, the number of wells, and aggregate fund usage reporting data received from municipalities and counties. Annual reports are delivered to the General Assembly and published to the Commission's dedicated Act 13 website. Website visitors can review specifics on funds collected and distributed for each year since 2011. The site allows individuals to search and download statistics such as distributions to individual municipalities or counties; allocation and usage of funds based on reports submitted by various municipalities; eligible wells per county/municipality; and payments by producers.

Performance Audit

In December of 2016, the Department of the Auditor General released its Performance Audit of the Commission's Act 13 administration. The Executive Summary of the Performance Audit stated the following:

“We reviewed the distributions to the conservation districts, state agencies, counties, and municipalities to verify whether PUC accurately distributed the Impact Fee funds for reporting years 2011-2014.

PUC does not obtain any support from the municipalities to validate the budget amounts submitted. With exception of relying on these self-reported budgets from the municipalities, PUC appears to have accurately calculated the Impact Fees distributed to the conservation districts, state agencies, counties, and municipalities, and accurately applied the municipality restriction limit in accordance with Act 13.”

Findings included in the audit also point to the potential benefit of additional training for municipal officials, which the Commission has provided and is working to enhance. These actions include the development of a webinar for municipal budget reporting and additional materials for municipal officials available on the Commission's Act 13 website. The Commission also continues to work with statewide associations for townships, boroughs, and county commissioners to communicate impact fee issues and updates. Further, the Commission entered into a Memorandum of Understanding with the Pennsylvania Department of Community and Economic Development in 2013 to provide ongoing outreach and training to municipalities.

Although the Commission was accurate in the calculation and distribution of funds, concerns were raised within the Performance Audit regarding the accuracy of budgets submitted by municipalities which serve as the basis for certain distributions. Additionally, a finding noted that a portion of impact fee expenditures reported to the Commission by some municipal recipients may not comport with the requirements as outlined in Act 13. As for these audit findings, specifically involving monitoring of local government spending and verification of budgets submitted by those entities, it is important to note that the Commission is not authorized to monitor, audit, or enforce local government spending of Act 13 funds – something that was clearly acknowledged in the audit report.

In our October 27, 2016 audit response letter, the Commission emphasized that other state agencies, including the Department of Auditor General, Office of Attorney General and County District Attorney Offices, the Department of Community and Economic Development, and the State Ethics Commission, have general audit and/or enforcement authority over county and municipal expenditures of Act 13 funds. As such, impact fees are subject to government oversight and audit at the state and local level. Broader discussions regarding the structure of the Act, reporting requirements for fee recipients, potential monitoring of impact fee uses, and other issues raised by the Auditor General are matters for the Pennsylvania General Assembly.

Commonwealth Court Decision

On March 29, 2017, the Commonwealth Court issued an opinion reversing the Commission's Order in the proceeding involving Snyder Brothers, Inc. The sole issue in the case was the interpretation of Act 13's definition for a certain subset of

gas wells called “stripper wells.” Under the Act, wells qualifying as stripper wells are not subject to impact fees. Act 13 defines these wells in the following manner.

"Stripper well" An unconventional gas well incapable of producing more than 90,000 cubic feet of gas per day during any calendar month, including production from all zones and multilateral well bores at a single well, without regard to whether the production is separately metered.

The Commission concluded, via Order entered June 11, 2015, that wells qualify as stripper wells, and are therefore exempt from the impact fee, if they do not produce more than 90,000 cubic feet (CF) of gas per day in each month of the year. In other words, wells that produce more than 90,000 CF in just one month of a calendar year do not meet the stripper well definition and are therefore subject to the impact fee.

In that Order, the Commission determined that the statutory definition of “stripper well” was ambiguous, stating that the word “any” had multiple meanings that materially affect the application of the stripper well impact fee exemption. Namely, the Commission concluded that “any” could be interpreted to mean “every,” “all,” “a,” or “one.” Based on rules of statutory construction the Commission concluded that, in this instance, the word “any” was not synonymous with “a” or “one,” but rather meant “every” or “all.”

The Commonwealth Court rejected the Commission’s position that the definition was ambiguous. The Court found that wells which do not produce more than 90,000 CF per day in any one month meet the stripper well definition and are therefore exempt from the impact fee. In other words, wells are subject to impact fees if they produce more than 90,000 CF per day during all twelve months of the year. Under the Court’s decision, wells that produce greater than 90,000 CF per day during 11 months of the year, but fail to produce greater than 90,000 CF per day in the remaining month of that year are not subject to the impact fee.

In response to the Commonwealth Court’s decision, the Commission has filed a Petition for Allowance of Appeal with the Pennsylvania Supreme Court. This Petition is presently pending. Additionally, on April 11, 2017, the Commission sent a letter to Governor Wolf as well as the House and Senate leadership. In that letter, the Commission summarized the issue and conveyed two items of concern regarding the Commonwealth Court decision. First, if Commonwealth Court decision had been made before the April 1st reporting deadline, the Commission calculated the impact fees for the 2016 reporting year would have reduced by approximately \$16 million. As well, reductions are expected to increase in future years given the age and

production level of wells and given producers' ability to fully take advantage of the Commonwealth Court's interpretation of this definition. Second, the Commission conveyed, to the extent it is deemed appropriate, a possible legislative solution to clarify the intention of the General Assembly regarding the definition. After discussions between the Commission and Democratic Staff, Representative Snyder introduced House Bill 1283 (HB 1283). HB 1283, as drafted, revises the definition of "stripper well" as follows:

"Stripper well" An unconventional gas well incapable of producing more than 90,000 cubic feet of gas per day during [any] **every** calendar month in **a calendar year**, including production from all zones and multilateral well bores at a single well, without regard to whether the production is separately metered.

Conclusion

The Commission holds the utmost respect for the Commonwealth Court and every decision it makes. In the course of administering the law, judicial bodies often come to constructive disagreements, as is their right. In this instance, it is the Commission's hope to educate the General Assembly about this proceeding so as to keep it duly informed while it evaluates policies related to the Commonwealth's natural gas production industry. In the meantime, the Commission will continue to steadfastly administer our responsibilities under Act 13.

The Commission is at your service should you have any questions.