

“What keeps you up at night?”

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Pennsylvania General Assembly Passes New Oil and Gas Law

Bill Awaits Governor's Signature

By Joel R. Burcat

On February 7, 2012, and February 8, 2012, respectively, the Pennsylvania Senate and the House of Representatives voted in favor of the Conference Committee's Report of House Bill 1950. H.B. 1950 (Printer's No. 3048) may be found at <http://www.legis.state.pa.us/CFDOCS/Legis/PN/Public/btCheck.cfm?txtType=PDF&sessYr=2011&sessInd=0&billBody=H&billTyp=B&billNbr=1950&pn=3048>. The extensive amendments to the Pennsylvania Oil and Gas Act contained in H.B. 1950, will bring Pennsylvania's regulation of oil and gas into the 21st century, and will establish, for the first time, an unconventional gas well fee ("drilling impact fee"). A summary of the Report of the Committee of Conference may be found at http://info.saulnews.com/reaction/documents/HB1950_Con_Report_Summary.pdf. The Report contains a detailed section by section description of all of the provisions of the bill.

It is expected that Governor Tom Corbett will quickly sign the bill into law. The drilling impact fee will go into effect immediately upon being signed into law. All other provisions of the bill will go into effect 60 days after the Governor signs it into law.

The bill contains a variety of provisions. These provisions include establishing a drilling impact fee and provide for the expenditure of funds generated by the impact fee to a variety of local and state uses. A key section of H.B. 1950 rewrites Pennsylvania's law dealing with the regulation of oil and gas drilling. This provision contains new mandates for permitting, bonding of well sites, setbacks, water replacement and a large number of regulatory provisions. A separate section of H.B. 1950 limits the ability of municipalities to regulate oil and gas drilling activities and has been the subject of some controversy.

This new bill will have a wide ranging impact on oil and gas exploration and production companies, landowners, municipalities, and all others involved in conventional and unconventional oil and gas drilling in Pennsylvania. Since approximately 60 percent of Pennsylvania is underlain by such formations, the bill will have a wide geographic and even social impact.

CHAPTER BY CHAPTER SUMMARY OF H.B. 1950

Drilling Impact Fee

Chapter 23 of the new bill creates a drilling impact fee. The drilling impact fee has been the subject of considerable controversy. Many, including the governor, have opposed the idea of a severance tax in Pennsylvania. Many others have argued in favor of a severance tax. Instead of a severance tax, however, the bill creates a drilling impact fee which provides for the payment of fees by operators to cover a variety of impacts to the Commonwealth. A significant portion of these funds will be used by local governments to cover the potential impacts of drilling. Some of the funds will be used by a variety of state agencies for a variety of purposes, not all of which are connected directly with gas drilling.

Section 2302 establishes an unconventional gas well fee. Before a municipality or county may receive any fee, however, the county must elect to impose the fee for unconventional wells located in its county. If it refuses or fails to elect to impose the fee, municipalities within the county may band together to compel the county to impose the fee.

The fee is tied to the average price of natural gas. In the first year, depending upon the price of natural gas, the fee may be as low as \$40,000 per well to as high as \$60,000 per well. With each year after the drilling of the well the fee declines, until the 15th year following the drilling of the well when, depending upon the price of natural gas, the fee for active wells may be as low as \$5,000 to as high as \$10,000. After that, there is no fee.

It has been estimated that in the first year, the impact fee will generate \$180 Million. This pot of money will be used to fund the variety of activities described in the bill.

The bill establishes that the Pennsylvania Public Utility Commission (PUC) is charged with annually adjusting the fee on the basis of the consumer price index and average price of natural gas. The PUC will have other duties that are described below.

Section 2304 establishes that the Pennsylvania Department of Environmental Protection (DEP) shall provide to the PUC a list of all unconventional wells that received a drilling permit. On the basis of

this list, the operators of the wells will be charged the impact fee. The PUC will be responsible for calculating and collecting the fee imposed. Penalties are provided under the bill for failure to file reports required of operators and for failure to pay the fee in a timely manner.

Gas drillers are required to keep records, make reports and comply with new PUC regulations that will establish record-keeping requirements. Drillers are also required to report on the number of active wells that they are operating.

Section 2314 of the bill establishes a complicated mechanism for distribution of the fee. The fee is divided, initially, among County Conservation Districts, the Pennsylvania Fish and Boat Commission, the PUC, DEP, the Pennsylvania Emergency Management Agency, the State Fire Commissioner, the Pennsylvania Department of Transportation, and the Marcellus Shale Legacy Fund (for natural gas energy development programs). Once the aforementioned fees have been distributed (totaling approximately \$25 million in the first year), then 60 percent of the revenues remaining in the fund will be appropriated to qualifying counties and qualifying municipalities for purposes authorized by the bill. The first portion of these funds are designated for housing affordability and rehabilitation to increase the availability of affordable housing and for rental assistance. This appears to be in response to concerns as a result of the unavailability of reasonably priced housing in areas in which large numbers of non-local workers have moved in to work on drilling operations, displacing some local residents and driving up the price of rental housing. Counties with unconventional gas wells will receive 36 percent of the funds. Municipalities with unconventional gas wells will receive 37 percent of these funds. Depending upon their proximity to unconventional gas wells, municipalities in counties with unconventional gas wells will be able to receive an additional portion of the remaining 27 percent of the funds.

These funds may be used by municipalities for impacts associated with drilling operations. The funds obtained by counties and municipalities may be used for construction and reconstruction of roads, bridges and infrastructure, emergency preparedness, environmental programs, preservation of surface and groundwater, tax reduction, and other services and uses such as social services, judicial services and capital reserves.

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The remaining funds are to be distributed to the Marcellus Legacy Fund. This fund will provide funding for statewide projects, such as those involving acid mine discharges and abandoned mine restoration, orphan oil and gas well plugging, recreational uses, watershed and water quality programs, flood control projects, general highway and bridge improvement projects, water and sewer projects, and some funds will be designated for the planning and construction of projects relating to oil, natural gas or chemical industries.

Regulatory Provisions

Chapter 32 of the bill is a revision of the permitting, bonding and regulatory requirements contained in the existing Oil and Gas Act. While the bill continues many existing provisions of the Act, it adds or modifies a number of provisions. Section 3211 increases the distance for notice of unconventional well permit applications from 1,000 feet to 3,000 feet. The new requirements also expand DEP's ability to deny permits as a result of an applicant's or its parent's or subsidiary's current violations. The bill adds a requirement that unconventional well operations must have a DEP-approved water management plan for water withdrawals.

A new section, Section 3212.1, will enable municipalities and storage operators to submit comments on applications for permits. Section 3215 also extends the distance required as a setback for unconventional wells from 200 feet (existing requirement) to 500 feet from existing buildings or water wells. In addition, unconventional gas wells are not permitted to be drilled within 1,000 feet of any existing water well, surface water intake, reservoir or other water supply extraction point used by a water purveyor. Another new limitation is an increase in the setback distance for unconventional wells from 100 feet (existing requirement) to 300 feet from any stream, spring, or body of water, or wetland greater than one acre in size. Drilling and well sites within floodplains will have additional requirements under the bill. The bill also contains a number of exemptions and variances that may be granted by the Department from all of the distance limitations on the basis of a variety of factors, including the permission of the owner of the potentially impacted use.

With respect to the restoration of well sites, Section 3216 of the bill provides that DEP may extend the restoration period for an additional two years if certain conditions are met.

A controversial provision of the bill increases the distance setback and time frame for the presumption of damage to a water supply. Pursuant to existing law, a rebuttable presumption exists so that if contamination occurs within 1,000 feet and within six months of drilling it is presumed to have been caused by the drilling (subject to a number of defenses). Under the bill, the distance and duration of the rebuttable presumption for an unconventional well is increased from 1,000 feet (under current law) to 2,500 feet from the water supply. In addition, the duration of the presumption is increased from six months to 12 months.

The bill also contains additional and new requirements for containment for unconventional wells, transportation records regarding wastewater fluids, corrosion control requirements, gathering lines, well-control emergency response, plugging of wells, and reporting requirements.

Another new provision of the bill, Section 3222.1, contains extensive requirements for the disclosure of hydraulic fracturing chemicals. This provision requires DEP to post this information on its website unless it is determined that the information contains trade secrets or confidential proprietary information.

Recently, the existing Oil and Gas Act provision relating to bonding of wells has been called into question as being inadequate. Existing law provides for a bond of \$2,500 per well. The new provisions establish a base bond of \$4,000 for each well with a total wellbore length of less than 6,000 feet. Depending upon the number of wells owned by the operator, that bond may be increased to \$100,000 (for more than 250 wells), plus \$4,000 per well for a total bond up to a maximum of \$250,000. For wells of the total wellbore length of 6,000 feet or greater, the per well minimum bond is \$10,000 and the aggregate bond may be as high as \$600,000 for more than 150 wells.

The bill also contains a number of provisions relating to enforcement. Significantly, civil penalties are increased from the current amount of \$25,000 plus \$1,000 per day of ongoing violation, to \$75,000 plus \$5,000 per day of ongoing violation. DEP, rather than the Environmental Hearing Board (EHB), will now be authorized to assess civil penalties. Appeals from these assessments will be to the EHB.

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Related to this is a new mandate, Section 3262, that requires DEP to post inspection reports on its website. These reports will include the nature and description of violations, the operator’s written response to a violation (if available), the status of the violation and remedial steps taken by the operator or department to address violations.

Limitations on Municipal Regulation of Drilling Activities

Chapter 33 mandates greater uniformity in the way municipalities regulate oil and gas operations, including drilling, pipelines, compression stations and processing. While the bill preserves the power of municipal regulation under the Municipalities Planning Code and Flood Plain Management Act, the bill accomplishes uniformity by imposing specific guidelines for municipal regulation affecting zoning districts, setbacks from existing uses, sound level, construction activities, and hours of operation, among other subjects. Municipalities are also strictly limited from regulating oil and gas drilling activities in any manner that resembles the regulation that would be found under the environmental laws or pursuant to DEP regulation.

A controversial provision of an earlier version of the bill empowered the Pennsylvania Attorney General to be involved in and take action against municipalities that enacted ordinances that violated the provisions of the bill. A very limited version of those powers shift to the PUC. Prior to the enactment of its zoning or planning ordinance, a municipality may request the PUC to review the proposed ordinance to advise whether it may violate state law. The PUC may issue an advisory opinion. In the event an owner or operator of an oil and gas operation or any persons residing within the municipality are aggrieved by the local ordinance, they may request that the PUC review the ordinance to determine whether this violates state law. Pursuant to Section 3305, the determination made by the PUC is appealable to Pennsylvania’s Commonwealth Court.

In addition, any person may challenge the enactment or enforcement of a local ordinance to the Commonwealth Court to seek to invalidate or enjoin the local ordinance. Furthermore, if the challenge is successful, then the municipality will be deprived of impact fee funds and remain ineligible to receive funds generated by the drilling impact fee until the ordinance is amended or repealed or the appeal is reversed. The bill provides that the court may order a

local government to pay attorneys’ fees to the plaintiff if the municipality enacted or enforced the local ordinance “with willful or reckless disregard” for state law. Legal fees may be ordered by the court in the event a plaintiff brought a frivolous action or brought an action without substantial justification for claiming that the ordinance violated state law.

Effective dates

The drilling impact fee provision will go into effect immediately upon the signing of the bill into law by the governor. All other provisions will go into effect 60 days after the bill has been signed into law.

Conclusion

This new bill will have a wide ranging impact on oil and gas exploration and production companies, landowners, municipalities, and all others involved in unconventional oil and gas drilling in Pennsylvania. Since approximately 60 percent of the Commonwealth is underlain by such formations, once enacted, the bill will have a wide geographic and social impact.

For more detail on how HB 1950 affects pipeline operators, please click here:

http://www.saul.com/media/site_files/3077_OilGas021012.pdf

This Alert was written by Joel R. Burcat, a member of the firm’s Oil and Gas Practice. Joel can be reached at 717.257.7506 or jburcat@saul.com. This publication has been prepared by the Oil and Gas Practice for information purposes only.

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