

ENERGY ALERT

**MARCELLUS IMPACT FEE - LEGISLATIVE UPDATE
THE NEW PUC AND DEP REQUIREMENTS UNDER ACT 13****I. Introduction**

On February 14, 2012, Governor Tom Corbett signed House Bill 1950, into law, providing comprehensive changes to Pennsylvania's Oil and Gas Act, 58 P.S. §§ 601.101 *et seq* ("Act 13" or the "Act"). The Act imposes a first ever drilling impact fee on operators in the Commonwealth and attempts to institute uniformity among local drilling ordinances. In addition, Act 13 tasks the Pennsylvania Public Utility Commission ("PUC") with significant duties including determining whether local zoning ordinances are "reasonable." Another key player under the new Act is the Pennsylvania Department of Environmental Protection ("DEP"). Both the PUC and DEP will play an integral part in the administration and enforcement of Act 13. This alert will discuss the PUC and the DEP's roles under the three main portions of Act 13: implementation of a drilling impact fee, development, and regulation of local ordinances.

II. Drilling Impact Fee

Chapter 23 of the Act imposes a first ever drilling impact fee on operators of unconventional gas wells in the Commonwealth. Under the Act, an unconventional gas well is a bore hole drilled or being drilled in the production of natural gas from a geological shale formation. Revenue produced by the fee will primarily revert back to local communities as compensation for harmful impacts from drilling. Funds will also be distributed amongst state agencies with the remainder going into the newly created "Marcellus Legacy Fund." While counties and municipalities have the option of electing to impose fees, those local governmental entities who do not pass fee ordinances are prohibited from receiving such funds from the state. Municipalities within counties that do not pass fee ordinances may force counties to impose an ordinance if at least half of the municipalities within a county, or municipalities representing fifty-percent of a county population, adopt resolutions implementing the fee. All affected operators must submit a fee by September 1 of this year. Beginning in 2013, unconventional well fees will be due by April 1 of each year.

The amount of the impact fee for each well is based upon the average price of natural gas flow and declines each year after the initial drilling of the well. Over the course of the first fifteen years after a well is drilled, oil and gas companies may pay an impact fee of between \$190,000 and \$355,000. The fee is imposed on every producer of gas wells in Pennsylvania regardless of whether the drilling occurred prior to enactment of the fee. For purpose of determining the amount of the fee, unconventional gas wells drilled prior to February 14, 2012 are considered to be drilled in the calendar year prior to the imposition of the fee.

Act 13 will assess the equivalent of a 1% rate over the life of a typical shale well, according to an analysis by the Pennsylvania Budget and Policy Center. By comparison, drillers pay effective drilling tax rates of 3.4% in Arkansas, 5.4% in Texas and 6.1% in West Virginia on comparable deep gas wells.

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A. PUC

Up until now, the PUC has not been heavily involved with the Marcellus Shale development. The Act assigns a substantial amount of administrative and enforcement authority to the PUC, making the commission the primary enforcement agent of the new impact fee. With regard to administration, the PUC's duties include:

- (1) annually adjusting the amount of the impact fee to reflect changes in the Consumer Price Index beginning in January of 2013;
- (2) assessing an administrative fifty dollar annual fee against producers;
- (3) keeping track of all new unconventional gas wells that have received drilling permits. In this regard, the PUC will work with the DEP to initially ascertain all new unconventional gas wells;
- (4) work with the DEP to guarantee that all fees are paid for existing wells prior to the issuance of any new drilling permits.

In addition to administrative duties, the Act grants the PUC specific enforcement authority. Section 2307 instructs the PUC to make all inquiries and determinations necessary to calculate the amount of fees owed by well operators. If the PUC finds an operator's payments are delinquent, the Commission may issue a notice of amount due, challenge the amount of fee paid, and/or make an assessment. Generally, the PUC may enforce the new law by:

- (1) assessing interest on delinquent fees;
- (2) producing written notices to operators and the DEP;
- (3) issuing enforcement orders;
- (4) assessing civil penalties on producers who fail to pay the fee (not exceeding \$2,500 per violation). PUC action must be brought within three years of the offense and an interest of five percent per month, up to twenty-five percent, may be assessed on late fees.;
- (5) examining books, papers and records of producers; and
- (6) examining employees of producers under oath.

Under Act 13, the PUC is to administer the collection of the fee, however, noticeably missing from Chapter 23 is how the PUC will implement collection. PUC Chairman Rob Powelson indicated the Commission will outsource its collection duty to a private company. The PUC has a role in the distribution of the collected drilling impact funds. Under Section 2314, the initial distribution allocates funds between conservation districts and various state commissions and agencies, including the PUC and DEP. Following the initial distribution, the PUC is tasked with allotting the remaining sixty percent of revenues provided for in Section 2314. The PUC must account for all funds in an annual report submitted to the House and Senate Appropriations Committees and the House Environmental Resources and Energy Committee.

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B. DEP

Although the DEP has been the primary state regulatory agency for the Commonwealth to date, the DEP's involvement under the drilling impact fee provisions of the Act are minimal compared to the PUC. Under Chapter 23, the DEP initially must provide the PUC with a list of all new unconventional gas wells that have received a drilling permit. The list will provide the basis upon which operators will be charged an impact fee. Going forward, the DEP must confirm whether permit applicants have paid all fees owed for an existing well prior to issuing new drilling permits.

The DEP also has a new responsibility under the distribution portion of the Act. When funds are paid out from the Marcellus Legacy Fund, the DEP must work with the DCNR to review project applications as requested by the Commonwealth Financing Authority and provide recommendations on the priority of funding projects.

III. Development

While the development provisions of Act 13 do not delegate responsibilities to the PUC, Chapter 32 of the Act allocates considerable new responsibilities to the DEP and revises provisions previously applicable to the DEP. These provisions which, *inter alia*, revise the permitting and regulatory requirements in the Oil and Gas Act, affect the DEP with regard to oversight of drilling, permitting, disclosure, and enforcement of the new regulations.

A. Oversight and Disclosure

Providing for various well location restrictions, the DEP is authorized to grant exceptions to these restrictions if certain conditions are met. The same provision also allows the DEP to establish additional protective measures for the storage of hazardous chemicals and materials on unconventional well sites near water sources.

In addition, the DEP may extend the current nine-month well site restoration requirement if:

- (1) the extension will result in less environmental impact;
- (2) there will be more efficient development of the resources; or
- (3) site restoration cannot be achieved due to adverse weather, lack of fuel, equipment, or labor.

One of the more controversial provisions in the Act, which amends the time and distance used to create a rebuttable presumption if water contamination occurs near a well. Under the new Act, when contamination occurs within 2,500 feet from a water supply within twelve months, it is presumed to have been caused by the drilling. The DEP also must establish a toll-free telephone number for reporting cases of water contamination, publish on the DEP website confirmed cases of water supply contamination resulting from hydraulic fracturing, and ensure facilities seeking a National Pollutant Discharge Elimination System permit for treating and discharging wastewater from oil and gas activities is operated by a competent and qualified individual. If a wastewater spill occurs at a well site, the DEP must notify affected drinking water facilities. A noteworthy new provision of the Act involves disclosure requirements for hydraulic fracturing chemicals. Under these requirements the DEP must post notification information on its website, determine how the chemical disclosure registry may be searched and sorted, and prevent the disclosure of trade secrets and confidential proprietary information.

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B. Permitting and Enforcement

The Act, which increases the notice distance of unconventional wells by two-thousand additional feet, gives the DEP expanded authority to deny permit requests as a result of current violations by the applicant, or a related entity to the applicant.

The DEP's enforcement authority under Chapter 32 allows the department to revoke drilling permits in instances of continuing violations of state law if the likely result of the violation is unsafe operations or environmental damage. Under this provision, aggrieved operators may appeal to the Environmental Hearing Board for relief.

The DEP may also enforce the provisions of Chapter 32 by assessing civil fines up to either \$25,000 plus \$1,000 a day or \$75,000 plus \$5,000 a day. The Department is mandated to post all inspection reports on its website including the nature and description of violations, the operator's written response, the status of the violation, and remedial steps taken by the operator or department to address violations.

IV. Local Ordinances

Perhaps the most contentious section of the Act, Chapter 33 limits the ability of municipalities to regulate oil and gas drilling activities by superseding all local ordinances adopted pursuant to the Pennsylvania Municipalities Planning Code and the Flood Plain Management Act. As in the impact fee portion of the Act, the PUC has a significant role in the local ordinance provision.

In an effort to establish regulatory consistency and predictability for industry players, the Act assigns the PUC with deciding whether local zoning ordinances are "reasonable." If the PUC determines that a zoning ordinance is in violation of the provisions of Act 13, aggrieved parties may seek relief by challenging the determination in Commonwealth Court. In addition, aggrieved parties may appeal local zoning ordinances directly to the Commonwealth Court as opposed to seeking relief from the PUC. In a similar capacity, the PUC will provide advisory opinions on the validity of local ordinances so communities can draft ordinances in the most efficient manner possible. If the PUC, Commonwealth Court or Supreme Court determines that a local ordinance violates state law, the local government enacting the ordinance will immediately become ineligible to receive funds from the drilling impact fee. To carry out these considerable new duties, the Act allows the PUC to issue orders, promulgate regulations, and employ additional individuals. Chapter 33 of the Act is effective beginning April 16, 2012. At that time, the PUC will accept requests for review filed by producers or residents regarding local ordinances.

V. Conclusion

Act 13 materially changes certain aspects of oil and gas law in the Commonwealth and may have a substantial impact on citizens and the industry alike. Affected individuals and companies will closely watch the PUC to determine how the Commission will proceed in its new regulatory role as arbiter of "reasonable" zoning ordinances. In addition, both the DEP and PUC's new administrative and enforcement roles will be scrutinized due to the unfamiliarity of the new oil and gas regulatory system as provided for in Act 13. Accordingly, the evolution of oil and gas law in Pennsylvania governed by Act 13 will be determined by the forthcoming decisions and actions of the DEP and PUC.

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Within the next few weeks, the PUC will issue a Tentative Implementation Order addressing various issues and proposed procedures related to the Commission's duties under Act 13. In addition, the PUC will provide a forum for public comment on local implementation plans before those plans become final.

This Alert is intended to keep readers current on energy matters, and is not intended to be legal advice. Eckert Seamans can assist you in understanding this new law and its impact on your operations. Importantly, we can also advise you how to maintain compliance with Act 13 and other applicable laws and regulations. If you would like more information on the new law or assistance in understanding how your interests may be affected by the PUC's and DEP's actions, please contact Dan Clearfield, Jeff Norton, Scott Dismukes or any one of our other Energy Group attorneys at Eckert Seamans.

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