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*Practice Group(s):**Energy, Infrastructure  
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## Pennsylvania Legislation Authorizing Counties to Levy Unconventional Gas Well Fee Signed Into Law

By Raymond P. Pepe

### Summary

On February 14, 2012, Pennsylvania's Governor, Tom Corbett, signed into law legislation (House Bill 1950)<sup>1</sup> authorizing counties to impose a fee on persons holding permits to sever natural gas for sale, profit or commercial use in the Commonwealth.<sup>2</sup> The fee is imposed annually on each bore hole spud in the immediately prior year and applies only to wells drilled to produce gas from "unconventional" shale formations which require hydraulic fracture treatments or multilateral bore holes to produce gas at economic flow rates.<sup>3</sup> The legislation takes effect immediately.

The fee applies to wells developed for the production of all types of hydrocarbon gases, including associated gas or casing head gas from oil fields, non-associated gas from reservoirs that do not contain significant quantities of crude oil, and gas produced from coal beds, shale beds and other formations, but does not apply to coal bed methane, or to wells used to recover gas from storage sites from which the gas did not originate.

The obligation to pay the fee arises when the drilling actually begins regardless of when the well is completed and applies regardless of whether and when the well produces any natural gas.<sup>4</sup> Once the obligation to pay the fee arises, it continues annually for a period of 15 years unless the obligation to pay the fee is suspended because the well is capped or fails to produce more than 90,000 cubic feet of gas per day during any calendar month within two years,<sup>5</sup> or the well is plugged.<sup>6</sup>

Within 60 days after the effective date of the legislation, i.e., on or before April 14, 2012, the fee may be imposed by the adoption of an ordinance by the governing body of any Pennsylvania county which

<sup>1</sup> House Bill 1950, Printer's No. 3948. The text of the legislation is available at:

<http://www.legis.state.pa.us/cfdocs/legis/PN/Public/btCheck.cfm?txtType=HTM&sessYr=2011&sessInd=0&billBody=H&billType=B&billNbr=1950&pn=3048>.

<sup>2</sup> The fee is imposed upon "every producer." 58 Pa.C.S. § 2302(b). A "producer" is a person "that holds a permit or other authorization to engage in the business of severing natural gas for sale profit or commercial use from an unconventional gas well in this Commonwealth." 58 Pa.C.S. § 2301.

<sup>3</sup> As used in the legislation, an "unconventional formation" is a "geologic shale formation existing below the base of the Elk Sandstone or its geologic equivalent stratigraphic interval where natural gas generally cannot be produced at flow rates or in economic volumes except by vertical or horizontal well bores stimulated by hydraulic fracture treatments or by using multilateral well bores or other techniques to expose more of the formation to the well bore." 58 Pa.C.S. § 3201.

<sup>4</sup> The fee applies to "unconventional gas wells spud in this Commonwealth." 58 Pa.C.S. § 2302(b). The term "spud" is defined to mean "the actual start of drilling of an unconventional gas well." 58 Pa.C.S. § 2301.

<sup>5</sup> The obligation to pay the fee is suspended "if a spud unconventional gas well begins paying the fee ... and is subsequently capped or does not produce natural gas in quantities greater than a stripper well within two years after paying the initial fee." 58 Pa.C.S. § 2302(b.1). A "stripper well" is a 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 to production is separately metered." 58 Pa.C.S. § 3201.

<sup>6</sup> The obligation to pay the fee ceases upon certification by the Department of Environmental Protection that a gas well has ceased production and has been plugged according to the department's regulations. 58 Pa.C.S. § 3201(e).

## Pennsylvania Legislation Authorizing Counties to Levy Unconventional Gas Well Fee Signed Into Law

has an unconventional gas well located within its borders. If a county fails to enact an ordinance imposing the fee, however, the fee may be imposed by the adoption of resolutions by at least half the municipalities in the county, or by municipalities representing 50% of the population of the county, not later than 120-days after the effective date of the legislation, i.e., on or before June 13, 2012.

Once imposed by counties or municipalities, the fee is collected by the Public Utility Commission (“PUC”) and 60% of its proceeds are returned to the counties and municipalities where wells are located. Counties failing to impose the fee by April 14, 2012, however, lose eligibility for the distribution of fee revenues for 2013, but may regain distributions by the adoption of an ordinance imposing the fee beginning in the year following the adoption of the ordinance.<sup>7</sup>

Funds not distributed to counties and municipalities are allocated for use by a number of Commonwealth agencies and programs, including the Unconventional Gas Well Fund, county conservation districts, the Fish and Boat Commission, Department of Environmental Protection, the Pennsylvania Emergency Management Agency, the State Fire Commission, the Marcellus Legacy Fund, the Housing Affordability and Enhancement Fund, and the PUC.

### Amounts of Fees Imposed

The fee is applied for a period of 15 years following its imposition for existing nonconventional wells,<sup>8</sup> or for 15 years following the commencement of drilling for new wells. The amount of the fee varies based upon (1) the number of years after either the commencement of drilling for new wells or the year the fee is imposed for existing wells; (2) the average annual price of natural gas as determined using the New York Mercantile Exchange average settled price for near-month contracts on the last trading day of each month; (3) the Consumer Price Index for All Urban Consumers; and (4) whether a well has a single vertical bore. The schedule of fees for 2012 is listed below, and will be adjusted annually beginning in 2013 based upon the CPI.

Years Following Commencement of Drilling or Adoption of the Fee	Average Annual Price of Natural Gas per MMBtu				
	Not More Than \$2.25	Greater Than \$2.25 and Less Than \$3.00	Greater Than \$2.99 and Less Than \$5.00	Greater Than \$4.99 and Less Than \$6.00	More Than \$5.99
Year One	\$40,000	\$45,000	\$50,000	\$55,000	\$60,000
Year Two	\$30,000	\$35,500	\$40,000	\$45,000	\$55,000
Year Three	\$25,000	\$30,000		\$40,000	\$50,000
Year 4 to 1	\$10,000	\$15,000	\$20,000		
Year 11 to 15	\$5,000		\$10,000		

<sup>7</sup> Without the imposition of a resolution imposing the fee, counties appear to lose eligibility for distributions even if the fee is imposed by the action of municipalities within the county.

<sup>8</sup> Section 2302(b) provides the following: “The fee adopted under subsection (a), (a.1) or (a.4) is imposed on every producer and shall apply to unconventional gas wells spud in this Commonwealth regardless of when spudding occurred. Unconventional gas wells spud before the fee is imposed shall be considered to be spud in the calendar year prior to the imposition of the fee for purposes of determining the fee under this subsection.” (emphasis added).

## Pennsylvania Legislation Authorizing Counties to Levy Unconventional Gas Well Fee Signed Into Law

Wells consisting of single vertical bore developed using hydraulic fracturing and which produce quantities greater than a “stripper well,” i.e., more than 90,000 cubic feet of gas per day during a calendar month, are subject to 20% of the otherwise applicable fee, but are not subject to the fee for years 11 to 15. The fee is not required for any well that has ceased production and has been plugged in accordance with the regulations of the Department of Environmental Protection.

The 15 year period during which fee payments are required is extended if a well is re-stimulated more than ten years after originally being drilled by hydraulic fracturing, using additional multilateral well bores, deeper drilling or other techniques to expose more of the formation to the well bore and the re-stimulation increases production by more than 90,000 cubic feet of gas per day during a calendar month. Re-stimulation extends the period for which the fee is due for 15 years commencing with the year in which re-stimulation occurs.

If a producer begins paying the fee for a well, and the well is subsequently capped or does not produce quantities greater than a “stripper well” within two years after paying the initial fee, the fee is suspended. Following suspension, if a well resumes generating quantities greater than a stripper well, the fee is reinstated, but calendar years during which the fee was suspended are not considered a year following drilling or imposition of the fee for purposes of applying the fee schedule.

The rationale for varying the amount of the fee based on how many years have elapsed since drilling began is based on the recognition that greater governmental costs are incurred during the development of new wells, especially during the time producers haul of sand, fracturing fluid and waste water used in fracturing, and that as wells age, they become significantly less productive and valuable assets. Notwithstanding this rationale, however, the legislation imposes the same fees on wells drilled prior to the imposition of the fee, regardless of when the wells were developed and how productive or socially costly the wells continue to be, as are imposed on new wells. For example, wells drilled to penetrate the Onondaga Formation or below under the Oil and Gas Conservation Act of 1961, which required fracturing to produce gas in economic flow volumes, may be subject to the fee. Similarly, subject to the limited exceptions provided for stripper wells and wells that are capped or plugged, all wells that fit into a given fee category based on the number of years elapsed since either the commencement of drilling, or the imposition of the fee, whichever occurs later, are subject to same fees, regardless of their productivity. In addition, the same fees are imposed on wells that fit into a given fee category, regardless of whether wells utilize hydraulic fracturing or other unconventional gas extraction technologies.

### Administration

For drilling commenced prior to January 1, 2012, the fee is due by September 1, 2012, and by September 1<sup>st</sup> of each year thereafter. For drilling commenced on or after January 1, 2012, the fee is due by April 1, 2013, and by April 1<sup>st</sup> of each year thereafter. When paying the fee, each producer is required to submit a report identifying the number of nonconventional wells located in each municipality within a county that has imposed the fee and the date each well was “spud” (i.e., the date drilling commenced).

To pay for the costs directly attributable to administering the fee program, the PUC may impose an administrative charge not to exceed \$50 per spud unconventional well. The PUC is also required within 30 days the legislation is signed into law, i.e., by March 15, 2012, to estimate its costs directly attributable to administering the fee program, less amounts collected from the PUC’s administrative fee, through June 30, 2012, and assess these costs on all producers. By June 30, 2012, and by June 30<sup>th</sup> of each subsequent year, the PUC is also required to estimate and assess its administrative costs

## Pennsylvania Legislation Authorizing Counties to Levy Unconventional Gas Well Fee Signed Into Law

upon producers for the upcoming year. Fees and costs assessments must be paid within 30 days of receipt of notice of the amount due from the PUC.

Within 14 days of the effective date of the legislation, i.e., by February 28, 2012, the Department of Environmental Protection is required to provide the PUC, and counties upon request, a list of all unconventional wells drilled in the Commonwealth. This list must be updated monthly. The Department of Environmental Protection is also prohibited from issuing drilling permits to any producers failing to pay fees when due, and is required to suspend permits issued to producers failing to pay any fees not subject to pending appeals. To enable the Department of Environmental Protection to enforce these requirements, the PUC is authorized to provide information to the department regarding fees owed and paid.

The PUC is given broad authority to make all inquiries and determinations necessary to calculate and collect the fee and its administrative charges and assessments, and to issue enforcement orders. The PUC may challenge the amount of a fee due within three years after a producer's report is filed which accompanies the fee payment. If no report is filed, or a producer files a false or fraudulent report "with intent to evade the fee," an assessment of the amount due may be made at any time. Enforcement orders issued by the PUC are subject to appeal to the Commonwealth Court. Producers have a "duty to comply" with enforcement orders issued by the PUC, and upon failure to comply may be punished by a court of competent jurisdiction.

When assessments are made for unpaid or underpaid fees, the PUC is required to add interest payments in amounts specified by the PUC and penalties of 5% per month, but not more than 25% of the amount due. The PUC is also authorized to assess civil penalties of \$2,500 for each violation of any of the requirements of the House Bill 1950 at any time up to three years after the violation. Unpaid fees, fines, interest and penalties constitute a lien "upon the property of the producer" after judgment in favor of the Commonwealth is entered and docketed in the county in which the property is located.

The PUC is also given broad authority to conduct examinations, including access to all relevant books and records of a producer; the power to require the preservation of records for up to three years from the calendar years to which the records relate; the power to examine employees under oath and the power to compel the production of books and records. All information obtained by the PUC is confidential and may not be disclosed, except in accordance with a judicial order or as provided by law.

### Legal Issues Raised by the Legislation

#### *Fee vs. Tax*

While House Bill 1950 purports to enact a fee rather than a tax because of political opposition to the imposition of any new taxes, it is unclear whether the amounts imposed under the new statute constitute fees or taxes for purposes of legal requirements limiting each. Under Pennsylvania law, fees generally may not exceed the reasonably estimated costs of providing governmental services,<sup>9</sup> while taxes are subject to the "uniformity clause" of the Pennsylvania Constitution and the equal protection requirements of the 14<sup>th</sup> Amendment to the United States Constitution.<sup>10</sup>

<sup>9</sup> *Rizzo v. City of Philadelphia*, 668 A.2d 236, 238 (Pa. Cmwlth. 1995) (Fees are legally collectible so long as the amounts charged "are reasonably proportional to the costs of the regulation or the services performed.").

<sup>10</sup> Art. VIII, § 1 of the Pennsylvania Constitution provides that "[a]ll taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws." The 14<sup>th</sup> Amendment to the United States Constitution adopted in 1866 provides that "[n]o State shall make or enforce any law which shall ... deny any person within its jurisdiction the equal protection of the laws." While initially the 14<sup>th</sup>

## Pennsylvania Legislation Authorizing Counties to Levy Unconventional Gas Well Fee Signed Into Law

In determining whether a law imposes a tax or a fee, the characterization of the imposition by the law itself may be disregarded, if the intent of the law is otherwise clear. In this regard, levies imposed to pay for the general expenses of government, or earmarked for certain programs that have a broad benefit to the public, are generally regarded as taxes rather than fees.

### *The Uniformity Clause*

To the extent the unconventional gas well fee is determined to be a tax, Pennsylvania judicial precedent interpreting the uniformity clause of the State Constitution is unpredictable. Under the uniformity clause, although like persons are to be treated alike, the General Assembly has the power to create different classifications as long as a classification bears a reasonable relationship to a legitimate state purpose.<sup>11</sup> A classification, even if discriminatory, is reasonable if the classification “is based upon some legitimate distinction between the classes that provides a non-arbitrary and reasonable and just basis for the different treatment.”<sup>12</sup> Valid classifications for the purpose of taxation may be based on “the existence of differences recognized in the business world, on the want of adaptability of the subjects to the same method of taxation, upon the impracticability of applying to them the same methods so as to produce justice and reasonably uniform results, or upon well grounded considerations of public policy.”<sup>13</sup> Distinctions in tax statutes are permissible if they are based upon “reasonable consideration of differences of policy and [bear] a reasonable and just relation to the act in which it is proposed.”<sup>14</sup>

The difficulty with applying these general rules concerning uniformity often arises in determining whether classifications that may be otherwise permissible for certain purposes reasonably further legitimate public policy objectives embodied in a taxing statute. This task is made more difficult because objectives justifying classifications are frequently not well articulated in taxing statutes, and courts are not limited to evaluating the reasonableness of classifications based upon legislative pronouncements. Instead “a reviewing court is free to hypothesize reasons the legislature might have had for the classification.”<sup>15</sup> Given this discretion, it is not surprising that different courts at different times may arrive at differing conclusions based on similar factual scenarios. For example, while a corporate net income tax based on federal taxable income was found not to violate uniformity requirements,<sup>16</sup> a personal income tax based on federal taxable income was found by the State Supreme Court to violate the Uniformity Clause.<sup>17</sup>

Applying principles of uniformity to the unconventional gas well fee is potentially challenging because the fee is not imposed on all wells or varied based on a small number of factors. Instead exemptions from the fee are provided under different conditions to stripper wells, capped wells, vertical wells and plugged wells; the amount of the fee may vary within the same year on similar types of facilities; and the law treats single vertical bore wells differently from other wells. In this regard, provisions of the law providing that “unconventional wells spud before the fee is imposed shall be

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Amendment was not applied to laws imposing taxes, since 1890 it has been interpreted as prohibiting state taxes which impose “clear and hostile discriminations against particular persons and classes.” *Bells Gap R.R. v. Pennsylvania*, 134 U.S. 232, 236-37 (1890).

<sup>11</sup> *Harrisburg School District v. Zogby*, 574 Pa. 121, 137, 828 A.2d 1079, 1088 (2003).

<sup>12</sup> *Leonard v. Thornburgh*, 507 Pa. 317, 321, 489 A.2d 1349, 1350 (1985).

<sup>13</sup> *Allegheny County v. Al Monzo*, 509 Pa. at 38, 500 A.2d at 1102, quoting *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940).

<sup>14</sup> *Philadelphia v. Smith*, 412 Pa. 262, 268, 194 A.2d 177, 180 (Pa. 1963).

<sup>15</sup> *Harrisburg School District v. Zogby*, 574 Pa. at 137-38, 828 A.2d at 1089.

<sup>16</sup> *Commonwealth v. Budd Co.*, 379 Pa. 159, 108 A.2d 563 (1954), appeal dismissed, 349 U.S. 935 (1955).

<sup>17</sup> *Amidon v. Kane*, 444 Pa. 38, 279 A.2d 53 (1971).

## Pennsylvania Legislation Authorizing Counties to Levy Unconventional Gas Well Fee Signed Into Law

considered as spud in the calendar year prior to the imposition of the fee,” may be particularly problematic.

### *Retroactivity Issues*

The treatment of existing wells in the same manner as new wells, regardless of how many years prior to imposition of the fee the wells were drilled, may also raise questions about whether the fee is being unlawfully imposed retroactively on the drilling of existing wells. In general, taxes may not be imposed retroactively to a date sooner than the first day of the legislative session prior to the session in which a tax is imposed.<sup>18</sup>

### *Interpretation Issues*

Significant interpretive issues regarding the imposition of the unconventional gas well fee may also arise. For example, questions may arise regarding whether particular wells are used for the production of natural gas from “unconventional formations.” The fee is imposed on wells drilled for the production of gas from any “geologic shale formation below the base of the Elk Sandstone or its geologic equivalent stratigraphic interval.” Questions may arise about the location of the Elk Sandstone or what constitutes a geologic equivalent stratigraphic interval.

It is likewise unclear how the exemptions for capped wells, stripper wells and plugged wells will be applied. With respect to capped wells or stripper wells, it is unclear whether the exemption applies after the fee has been paid for a two or a three year period.<sup>19</sup> With respect to plugged wells, the legislation does not clarify when the exemption takes effect. Finally, with respect to all wells eligible for exemptions, the legislation does not clarify whether, and in what circumstances, refunds may be available for fees paid unnecessarily.

Questions may similarly arise about whether the 80% discount for vertical wells applies to all nonconventional vertical wells, or only to vertical wells that have been fraced. Generally, the fee applies to wells drilled for the purpose of producing gas from formations that require fracing, multilateral well bores or similar technologies to sever gas at economic flow rates regardless of whether such procedures are used, but the 20% fee on vertical wells applies only to wells that utilize fracing.

### *Administrative Procedure Questions*

Significant issues relating to administrative procedures also may arise. For example, it is unclear whether petitions for refunds of improperly paid taxes must be filed with the PUC or with the Board of Finance and Revenue; whether petitions for reassessment may be filed with the PUC; and whether appeals of tax assessments before the Commonwealth Court are subject to *de novo* review in the same manner as all other tax assessments. Likewise, it is unclear whether enforcement orders of the PUC, especially those regarding tax assessments, will be stayed pending administrative review in the same

<sup>18</sup> *Commonwealth v. Budd Co.*, 108 A.2d at 569 (citing *Welch v. Henry*, 305 U.S. 134 (1938)).

<sup>19</sup> To qualify for the special tax provisions applicable to stripper wells, a well must not have generated more than stripper well volumes within two years of paying the initial fee. For example, for a well in existence prior to January 1, 2012, the initial fee is required to be paid on September 1, 2012. If the well does not produce more than stripper well volumes by January 1, 2014, the fee is suspended. It is unclear, however, whether the suspension applies immediately to the fee due on January 1, 2014, in which only the 2012 and 2013 fee would have been paid, or whether the suspension takes effect the following year. The resolution of this issue may depend on whether the stripper well provisions constitute a tax exemption, which must be strictly construed against the taxpayer under Pennsylvania law, or an exclusion from the scope of the tax, which must be strictly construed as a limitation on the ability of the Commonwealth to impose a tax.

# Pennsylvania Legislation Authorizing Counties to Levy Unconventional Gas Well Fee Signed Into Law

manner as other taxes, or whether the assessments must first be paid under threat of contempt and only challenged through petitions for refunds filed with the PUC or the Board of Finance and Revenue.

In order to implement its responsibilities to administer the fee, the PUC may adopt policies and regulations which resolve some of these issues and provide guidance to producers regarding reporting, recordkeeping and other requirements necessary for the administration of the fee.

### Conclusion

The impact fee provisions of the new law present a wide range of interesting and potentially troublesome legal issues, interpretation questions, and unresolved administrative procedure quandaries that will need to be worked through in the months, and perhaps years, ahead. Passage of House Bill 1850 is merely the first step in what is expected to be a long, and perhaps uncertain, process of implementing and administering an impact fee arrangement in Pennsylvania.

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