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Natural Gas Production and Severance Taxes

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Charlie Burd is Executive Director of the Independent Oil and Gas Association of West Virginia, where he manages the day-to-day operations of the nearly 600-member trade association and oversees its legislative efforts. Prior to joining the association in 2002, he enjoyed a 29-year career at Hope Gas, Inc.

Burd holds an associate's degree in accounting from Mountain State College, a Regents bachelor's degree from Glenville State College and is a 1995 graduate of the University of Oklahoma's Economic Development Institute. He has earned the national distinction as a Certified Economic Developer and is a 2001 graduate of Leadership West Virginia.

Burd serves on the Industry Advisory Committees for West Virginia University's College of Petroleum and Natural Gas Engineering, WVU's Energy and Land Management Program and WVU's West Virginia Manufacturing Extension Partnership. He is active with the Independent Petroleum Association of America, the West Virginia Chamber of Commerce and the West Virginia Manufacturers Association. He is West Virginia's representative to the Interstate Oil and Gas Compact Commission on behalf of Governor Jim Justice.

In 2017, Burd was honored as the "West Virginia Oil and Gas Man of the Year" by the West Virginia Oil and Gas Festival Board of Directors.

The implementation of severance taxes in West Virginia dates back to a "gross sales tax" first imposed on July 1, 1921. Today, West Virginia is one of 35 states that imposes a severance tax on the extraction of oil and natural gas, currently set at five percent on gross receipts from the wellhead value of oil and natural gas produced.

Record Production

According to the U. S. Energy Information Administration (EIA), West Virginia is the ninth largest natural gas-producing state in the nation, largely because of shale gas production. Natural gas production from shale wells surpassed the production from all other natural gas wells in the state for the first time in 2011. Annual production exceeded one trillion cubic feet for the first time just three years later. See chart below.

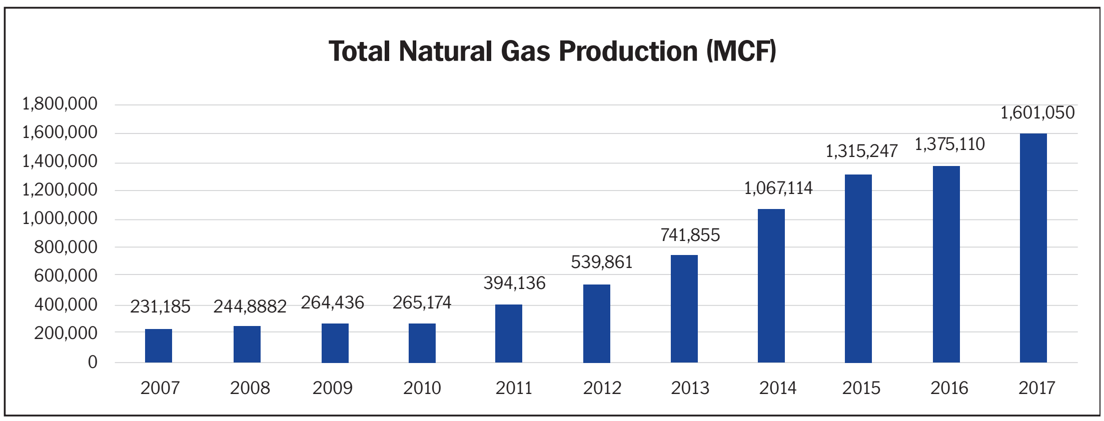
Lower Wellhead Prices

Beginning in 2008, with the onslaught of dozens of mid-continent oil and gas companies moving into the area, production soared and prices began to drop as gas produced from our region became more than just a supply used to meet peak demand periods. Gas from West Virginia, Ohio and Pennsylvania became the supply relied on at all times and all points in the central, southeastern and northeastern regions of the country. Gas from the Appalachian Basin is now being exported to Europe and other foreign jurisdictions, as well. As a product of these circumstances, the positive basis differential flipped to a "negative basis differential" and the lower wellhead prices took a toll on smaller independent producers unable to compete with the larger independents. The chart at the top of the opposite page illustrates how this increase in production led to wellhead prices dropping.

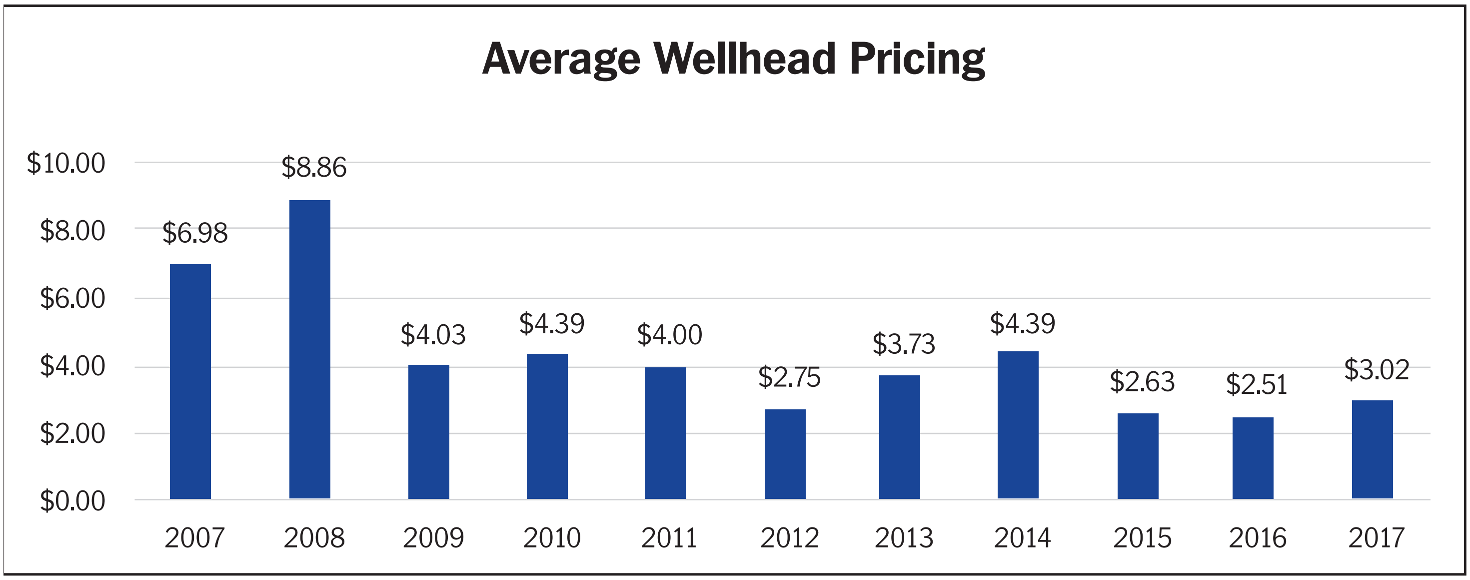
Appalachian Basin Not Enough

In 2008, the Federal Energy Regulatory Commission authorized the construction of REX-East pipeline to transport natural gas from the Rocky Mountains to eastern markets. The 42-inch diameter pipeline, which became fully operational in 2009, traverses 639 miles from an interconnection with the REX-West pipeline in Missouri. It continues through Illinois and Indiana, terminating at an interconnection with three pipelines at the Clarington Hub in Monroe County, Ohio: Dominion Transmission Inc., Dominion East Ohio and Texas Eastern Transmission LP.

This perfect storm of an unprecedented increase in production, coupled with the influx



Source: EIA



Source: EIA

of stranded gas from western reserves, established the immediate need to ship increased West Virginia and Appalachian Basin production via new pipeline takeaways to nontraditional markets in other parts of the United States.

As West Virginia producers were developing record volumes of natural gas, the net result was lower average wellhead prices. Mathematically, even with such large volumes of natural gas production, the effect was fluctuating severance tax collections on natural gas in West Virginia. See chart below.

Source: West Virginia Tax Department

Pipes Everywhere

With the REX pipeline in the ground, there emerged additional new pipeline takeaways. West Virginia and production from other parts of the Appalachian Basin drove the construction of nearly a dozen new interstate and intrastate pipeline projects in and through West Virginia – virtually all of which are now in some phase of application, permitting, construction or completion. These pipelines represent billions of dollars of capital investment and thousands of construction jobs for the West Virginia economy. The top six projects and their operators include:

- Atlantic Coast PL – Dominion
- Mountain Valley – EQT/JV
- Rover – Energy Transfer
- Mountaineer Express – Columbia
- Leach Express – Columbia
- WB Express – Columbia

Chicken and the Egg

As exciting as all these new pipelines may be, and as much gas as they can transport to markets outside West Virginia, it takes long-term regulatory and environmental certainty to be competitive with our neighboring states of Ohio and Pennsylvania. Until the most recent session of the West Virginia Legislature, producers there had the ability to better unitize tracts of land and develop longer drilling laterals. West Virginia took a positive step by enacting co-tenancy legislation that requires approval from 75 percent of interest owners on a tract of oil and gas in order to create legal authority for a lessee to proceed with drilling. Still, there is more to do in order to make West Virginia's natural gas industry competitive with Ohio and Pennsylvania. The following chart shows a comparison of the number of drilling rigs operating in the three states, and the clear advantage our competitors have due to their more business-friendly regulatory framework:

Appalachian Basin Rig Count Allocation

Marcellus & Utica Point Pleasant Shale

	9/2008	4/2018
OHIO	13	23
PENNSYLVANIA	16	40
WEST VIRGINIA	33	17
TOTAL	62	80

Source: Baker Hughes

It appears obvious from the 180-degree shift in state-by-state rig count that producers in Ohio and Pennsylvania enjoy more modern lease laws, a more stable

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Community Development Block Grant Funds Assist West Virginia Communities in Broadband Development

Kelly Workman

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to Narrow the Digital Divide and Increase Resilience to Natural Hazards."

In this rule, HUD directs that where access to broadband is not currently available or is minimally available, as in rural areas, states must consider ways to bring broadband access to residents, noting, "The importance of all Americans having access to the Internet cannot be overstated."

As HUD stated in its announcement of the Digital Opportunity Demonstration, published in the Federal Register on April 3, 2015, at 80 FR 18248, "Knowledge is a pillar to achieving the American Dream – a catalyst for upward mobility as well as an investment that ensures each generation is as successful as the last. Many low-income Americans do not have broadband Internet at home, contributing to the estimated 66 million Americans who are without the most basic digital literacy skills. Without broadband access and connectivity, and the skills to use Internet technology at home, children will miss out on the high-value educational, economic and social impact that high-speed Internet provides."

Upon HUD approval, West Virginia will receive approximately $13.5 million in fiscal year 2018 CDBG funding. The state intends to dedicate a base amount of $2 million to broadband development in one or more funding cycles, with the first application deadline of October 30, 2018. A second application cycle may be added in the spring of 2019. The WVDO will coordinate broadband projects with the West Virginia Broadband Enhancement Council, West Virginia Geological and Economic Survey and the West Virginia Office of GIS Coordination.

All West Virginia municipalities and counties are eligible to apply for CDBG funds, except entitlement cities that receive funds directly from HUD, including: Beckley, Charleston, Huntington, Martinsburg, Morgantown, Parkersburg, Weirton, Wheeling and Vienna. Matching funds are not required; however, projects that leverage other federal, state and local funding in the deployment of broadband infrastructure are encouraged. Local governments are generally required to partner with a Regional Planning and Development Council to develop applications and administer CDBG grants. CDBG funds may also serve as matching funds to eligible projects funded by other federal, state and private sources. V

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and fairly implemented tax structure and more regulatory and environmental regulations that lead to lower cost to explore, drill and operate. These factors can be summed up in higher rates of return on investment and greater profitability to owners and shareholders.

Getting Back in the Game

So how does West Virginia get back into the game? Like many other examples that could be cited from differing industries, West Virginia must simply become more business friendly and more attractive than its competition. The essence of which is in creating value through the utilization of our clean-burning, energy-efficient natural gas in future downstream petrochemical and manufacturing opportunities; increasing the number of natural gas-fired electric generation plants; piping its produced natural gas to facilities to be liquified and shipped, in many cases, to our allies who are growing more dependent for energy supplies; and, finally, in the development and completion of the Appalachian Storage and Trading Hub.

Economic Revitalization

The Appalachian Storage and Trading Hub, once completed, is expected to be the hope for West Virginia's future manufacturing resurgence. This multi-billion dollar investment will directly impact the entire Appalachian Basin, once again giving West Virginia the opportunity to be at the core of the second largest U.S. petrochemical and manufacturing epicenter. Dr. Brian Anderson, director of the West Virginia University Energy Institute, said it best, "Appalachia is poised for a renaissance of the petrochemical industry due to the availability of natural gas liquids. A critical path for this rebirth is through the development of infrastructure to support the industry. The Appalachian Storage Hub study is a first step for realizing that necessary infrastructure."

Hope for the Future

The first horizontal well drilled and placed by Chesapeake Energy in Marshall County, West Virginia a decade ago produces 37 times the amount of natural gas than it did in 2008. In that same time period, severance tax collections on natural gas has provided approximately $959 million in economic benefit to the citizens of West Virginia. Ten percent of those funds, or $95 million, was held aside and distributed to local governments for their use. The other 90 percent, or $864 million, was combined with personal income tax collections, sales and use tax collections, other severance taxes (primarily coal), the tobacco tax, B&O taxes and various other smaller tax streams. Add to this another $957 million paid in property taxes and an estimated $500 million annually in net, after expense, royalty payments.

By the time we are readying to ring in 2019, the West Virginia oil and natural gas industry will very likely have contributed well over $2 billion dollars to the state's economy – an economy that relies on these funds to pay for public education, military and public safety, social programs and deposits into the state's Rainy Day Fund.

Indeed, the natural gas industry holds a world of hope for the Mountain State – hope for diversification of West Virginia's economy; for in-state jobs to reverse the out-migration of our people; for revenues to sustain vital services for our citizens; for giving purpose to our education system; and for creating a renaissance for communities throughout the state. For these reasons and more, our governor and lawmakers should strive to develop responsible policies that pave the way for a truly competitive oil and natural gas industry in West Virginia that outshines its regional and national rivals. V